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OUR CONTRIBUTORS FOR THIS ISSUE

Howard Bloch – Professor of Economics, George Mason University; **Richard Brown** – Adjunct Faculty member, Empire State College, New York; **Robert E. Looney** – Associate Professor of National Security Affairs, Naval Postgraduate School, Monterey, California; **Bruce Powell Majors** – Political Scientist, Washington, D.C.; **Joseph Miranda** – Captain, U.S. Army, Fort Bragg; **Roger L. Pupp** – Associate Professor of Economics, George Washington University; **Dennis A. Rondinelli** – Professor, Maxwell School of Citizenship and Public Affairs, Syracuse University.

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General Editor

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POLITICAL WARFARE: CAN THE WEST SURVIVE?

By Joseph Miranda

Political warfare has become the decisive element in modern conflict. While some free nations, and particularly, America have attempted political operations since World War II they have not understood the underlying factors to properly conduct such efforts. The result has been an inability to contend with the various Communist and Third World political movements. Political warfare comprises those operations which are directed at the *will.* It includes the fields of propaganda, organization and resistance. In order to understand what free nations must do to successfully engage in political warfare the sources of their failures must be examined. Only then can a political warfare program be developed which will allow the West — including the United States of America — to survive in the modern world.(1)

The Western Worldview is Oriented towards Nation-States

America and most Western peoples tend to view conflict in terms of nation-state versus nation-state. Consequently, the Western powers have failed to effectively combat politically based movements like Communism, which are transnational in character. From the nation-state perspective, conflict is in traditional terms of "war" and "peace." Peace is the normal state of affairs between nation-states. Wars are the form of conflict. There is no middle ground. States are either at war or at peace, and both have their conventions. During peace, nations do not conduct hostile actions against each other. Instead, they negotiate to "reduce tensions." A structure of international law is erected to regulate behavior and settle disputes. Wars are also fought by convention. In order to begin a war, there must be a declaration. Combatants must wear recognizable uniforms. Attacks against noncombatants are restricted. The instruments of war are weapons which inflict death and destruction. Victory is obtained by defeating enemy armies in battle. Within this traditional framework of war and peace there is no place for political warfare. During peace it would be improper; during war, indecisive.

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However, an entirely new state of affairs was set into motion with the success of the Russian Revolution. With the rise of Communism as a major force in the world there arose a movement which was not based on the nation-state system. Communism is not only directly antithetical to the concept of the nation-state, and direct opposed to the Western worldview in its entirety, but has as its objective the destruction of all other civilizations and their replacement by an international Marxist-Leninist political order. Whereas the policies of the nation-states are designed to protect the peoples and culture of a nation, within the boundaries of its territory, Communism represents an international philosophy. It views conflicts not in terms of nation versus nation, but rather, as class versus class, with the Communist Party as the leader in the revolutionary struggle. The main conflict in the modern world is therefore not between nations, not even between superpowers, but between rival political systems.

The Communists understand, correctly, that there are struggles more important than the military; and that if a state's system or political structure collapses, then its military resources will be useless. They understand the vulnerability of the West in its failure to recognize the new international threat which challenges the survival of the concept of free nation-state and its clearcut war-peace dichotomy. They further realize that there is a vast area of conflict which is neither war nor peace. This is the political warfare level. Since the West does not customarily or clearly recognize the existence of this dimension of conflict, it fails to prepare defenses for itself in this vital area. It is against this vulnerability that the Communists have launched their political warfare offensives. In this, they have been emulated by Third World Revlutionaries, who propagandize for the redistribution of the wealth of the West under the euphemistic guise of creating a New International Economic Order, and the like.

This is why the United States has been unable to deal effectively with the Soviet Union. It insists on treating the Soviets as a "great power" in the traditional sense. It takes steps which might have made sense against Bismarck's Germany but make no sense in political warfare. America alternatively arms and disarms, opens negotiations and sends diplomatic protests. When the Soviet Union invaded Afghanistan in 1979 there was

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an international outcry against Soviet "aggression" and "imperialism." Yet the significant event occurred a year earlier, when Afghan Communists under Soviet direction seized control of the government. This event was largely ignored in the West. Why? Because the 1978 coup was seen as an internal affair among the Afghanis. Since no army had crossed the border there was no perception of aggression in the traditional sense. But the coup was the devisive event since it gave the Soviets political control of the country. The 1979 invasion was only a consolidation of their deteriorating political position, and only the subsequent Soviet Military invasion met with international protest. There is the same lack of perception by the West of all other political warfare activities directed against the West: the propaganda, the front organizations, the guerilla warfare. Since they are not what the West defines as "war" there is no consideration of them as a serious threat and no general attempt to counter them.

This is also why the West cannot properly deal with terrorism. It views terrorism in legalistic terms as a criminal act, rather than as a form of political warfare. But terrorism is not a random series of acts of violence. It represents a systematic and planned strategy for the destruction of the political system of the free world. The Viet Cong's attacks on South Vietnamese teachers and administrators during the early stages of the War were designed to destroy the political infrastructure of the Republic of Vietnam. And the traditional weapons of war cannot be used against the agents of political warfare. Bombers, aircraft carriers and armored divisions are helpless against an underground cell. Within the limits of the traditional Western view of conflict the steps necessary to counteract enemy political warfare are considered illegitimate. The destruction of the underground political organization of a guerilla movement requires extensive intelligence work, suspension of due process and quite often the killing of non-uniformed guerillas. But many in the West are horrified by such steps — even when morally and legally justified by traditional law enforcement procedures. The Phoenix program in Vietnam, which identified and eliminated members of the Viet Cong underground, came under criticism for being repressive and "bloody." Yet this was one of the few successful programs conducted by America in Vietnam — successful because it attacked the foundations of the

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Communist political infrastructure. Indeed, it was one of the reasons why, by 1972, the Viet Cong had been eliminated as a major force.(2)

To many Americans, "propaganda" is a distasteful word. It is incorrectly associated with lies or as interference in the internal affairs of nations with which America is at peace.(3) The public uproar over the CIA "Psychological Operations in Guerilla Warfare" manual is typical of the misunderstanding of political warfare. While the American public considers it legitimate to send millions of uniformed soldiers to their death in officially declared war, to see entire cities bombed into rubble with the consequent death of hundreds of thousands of civilians caught in the middle of battle, it reacts in horror to the "neutralization" of a enemy terrorists by comparable terrorist methods. The millions killed in conventional wars are killed in accordance with the laws and customs which have been ingrained as inherently right within the traditions of the West, but the tactics of the guerilla and the terrorist are essentially alien to the Western tradition, and attempts to combat them by their own methods consequently meet too often with revulsion.

America and the West are under attack by political warfare in a worldwide struggle which goes beyond any conflict in past Western experiences or even world experience. This is not simply a struggle between states for territory. What is at stake is the entire cultural heritage of the West. Should the West be defeated it will cease to exist as a distinct civilization. While the outward structure of its states and some of their symbols might persist in some form, purely as a guise to ease people's acceptance of the new order, the underlying civilization which is expressed in the concepts of rational and individual freedom would be replaced by universalist totalitarianism. In fact, already a massive portion of the world, including Eastern Europe and other parts of the Western world, have already fallen to the enemy. Through political warfare, Communism has come to dominate half the world. Through political warfare the prime influence of European civilization has been swept from the colonies in Africa and Asia. Through political warfare, the United States has been defeated in Vietnam, Iran, Panama and Nicaragua.

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America Political Operations are not Unified

Even America – economically most powerful defender of the Western tradition – fails to conduct long term, integrated political operations. Instead, its operations comprise a series of individual campaigns which can win only tactical victories at best. This is partially the result of the traditional war-peace view, which makes political warfare an auxilliary to the traditional instruments of diplomacy and the military. During peace, propaganda agencies simply broadcast "information" which explain current national policy. Support for insurgents is regarded only as part of a bargaining position against unfriendly countries, a way to modify their policies by pressuring them into negotiating. During war political operations are attempted to assist the armed forces in the destruction of the enemy, propaganda seeks to induce enemy soldiers to falter in their struggle, underground organizations gather intelligence and assist escaped prisoners of war, and guerilla movements harass enemy communications. But these means are not decisive – the real victory depends on properly uniformed and armed military forces.

America does have numerous political warfare agencies, but these are scattered throughout the government. They include the United States Information Agency, the Board for International Broadcasting, the Central Intelligence Agency and certain military units within the Department of Defense. While there have been attempts to place political warfare under central direction at the national level, each agency operates largely independent of each other.(4)

The United States Information Agency conducts cultural and news activities, such as providing information about American politics and history through United States embassies. It also runs the Voice of America radio broadcasting system. The Board for International Broadcasting controls Radio Free Europe and Radio Liberty. Radio Free Europe broadcasts to Eastern Europe, and Radio Liberty to the Soviet Union. Originally, both Radio Free Europe and Radio Liberty were run by the CIA, but in 1973 Congress established the Board for International Broadcasting to oversee their operations.(5)

The Central Intelligence Agency has conducted numerous political operations, and is usually associated in the public mind with these campaigns, largely through the sensationaliza-

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tion of a few of its major operations. Actually, there are several reasons for the CIA's involvement in political warfare. Many of its original members had been in America's Office of Strategic Services, which conducted resistance operations in World War II. They had the expertise to apply the lessons learned from these operations. Also, the CIA can spend funds without having to openly account for them. And it can conduct sensitive operations which cannot be traced back to the United States, an important factor when considering that many foreign political movements must have the appearance of complete independence from foreign interference.(6)

The first major CIA political operation was supporting democratic political parties in the 1948 Italian election. This was in response to a massive Soviet political offensive in support of the Italian Communist Party. President Truman had the CIA channel funds and provide political advisors to moderate Italian political parties. The result was the establishment of a democratic state in Italy in the post-war years.(7) The CIA gained much of its notoriety from two operations it conducted successfully in the 1950s. In 1953 the CIA assisted the Shah in gaining total power in Iran and defeating leftist Prime Minister Mossadegh.(8) In 1954 the CIA supported General Castillo Armas' exile forces in overthrowing the Marxist government in Guatemala.(9) The CIA also supported anti-Soviet freedom fighters in Eastern Europe during the 1950s. It smuggled arms to underground organizations prior to the 1956 Hungarian rebellion. Further, American radio broadcasts implied America would support a rebellion against the occupying forces of the Soviet Union.(10) In 1962 the CIA began to recruit and supply Laotian tribesmen as guerillas against Communist forces operating in that country.(11) The CIA eventually organized several other guerilla forces throughout Indochina which became potent striking forces. More recently, the CIA has provided support for the anti-Marxist *contras* in Nicaragua.

The United States armed forces have also conducted political warfare in one form or another. Following World War II, the U.S. armed forces occupied Germany and Japan, set up military governments, propagandized against National Socialist concepts and re-educated the people to accept a democratic system comprising a new set of political parties from which National Socialist parties were excluded by law. Several organizations

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within the Army have been developed for political warfare type missions. Army Special Forces' primary mission is the training of indigenous forces for warfare in an insurgency environment. This includes both defensive measures for counter-insurgency, and offensive measures in organizing guerilla units in enemy territory. Psychological operations units conduct propaganda in support of military operations. Civil Affairs units are responsible for military government and assisting friendly governments in the establishment of administrative structures in liberated areas. During the 1960s the Army organized Special Action Forces, built around Special Forces groups and including Psychological Operations, Civil Affairs and various types of intelligence, engineer and other units. These conducted several successful counter-insurgencies. They did so by training indigenous forces to improve their way of life with various educational and medical programs, and by training them to fight for themselves. They succeeded because they built political strength among the people and gave them something to fight for as an alternative to Communism.(12)

The problem with these and other American political operations is that they were never part of a cohesive strategy. Each operation was directed generally without regard for other elements of national policy. The CIA support for Hungarian freedom fighters turned into a disaster because the United States was not willing to commit its armed forces when the Hungarians rose against the Soviets in 1956. Vietnam was a total defeat for America because of a failure to unify military and political operations. No propaganda compaign was organized to mobilize support for the war, as the United States had done during both World Wars. Nor was there any serious attempt to counter Communist propaganda inside America. In Vietnam itself, the military war and the political war were conducted independently of each other. The tactical victories could not be exploited for their full political impact. The political victories could not be consolidated by military operations. And, more recently, the American support for the Nicaraguan *contras* is not part of a greater strategy. There is no propaganda support for it, nor is it clear whether America will – or will not – intervene with its military forces to complete the revolution against the Sandinistas.

American political operations have been defensive. They

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react to enemy political offensives. Each operation is at best a solution to a single crisis. This gives the opposition the initiative to conduct political warfare as it pleases. Soviet propaganda spreads disinformation about the United States: the Voice of America responds with a truth campaign. An unfriendly government threatens American interests in Iran: the CIA supports the Shah. Communists threaten to take control of Italy: the U.S. spends political advisors. The North Vietnamese are on the march in Indochina: CIA and Special Forces organize guerilla armies to fight them. Given this state of affairs the Communists can set the entire pace of the conflict while America rushes about, trying to put out fires.

There is no Current United States Political Program

A political program is the foundation for any political warfare campaign. Simply stated, it tells what one is for, who one is willing to support, what one is opposed to and what steps one will take. It cannot be a set of abstractions about "peace" or "national security": it must state concrete objectives. A political program sets the greater context in which political operations will function. America's failure to formulate a political program has only led to confusion. If the United States is for the West, then why did it support Nasser against Britain and France over the Suez in 1956? If the United States is for international law, then why does it intervene in the internal affairs of other countries? Does the United States plan to overthrow the Communist governments of Eastern Europe? And if not, then why does it support the Polish Solidarity movement? The objectives of the Soviet Communists, in contrast, are quite clear: the creation of an international, classless society controlled by the Communist Party. But what exactly is it that America wants?

Underlying all these other problems is a fundamental factor which America does not recognize: that in order for a political warfare program to succeed, it must have something to propagate. Political warfare is not merely an instrument of a civilization, it *is* the civilization. It expands the political system, which reflect the values of the civilization. The Communists do not view political warfare as merely a means of altering the international balance of power in their favor. Rather, it is a means to transform the world in their own image. And this is why,

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ultimately, the Western world has collapsed in the face of its enemies. Since the Western world no longer believes it has a civilization worth defending, it will not defend itself. The West withdrew from its African and Asian colonies because the political foundations for them no longer existed. Western colonialism had its origins in the faith among Western men in the supremacy of their own civilization, a civilization which would be propagated world wide by imperialism. But through the twentieth century, this faith has been eroded by various Marxist and internationalist political movements, until now the very words "imperialism" and "colonialism" are considered terms of disparagement by both conservatives and liberals. Support for colonial wars could not be maintained because the European peoples no longer believed their civilization was worth expanding. The political position of the colonial powers collapsed at home and they withdrew from the colonies, regardless of the outcome of the military situation. The United States could not triumph in Vietnam as its civilization came under attack by radicals at home. Nor can a Europe which has no pride in its history be expected to defend itself from the political assaults of the Soviets. The current European antiwar movement is only a manifestation of the general Western failure of will, a failure which has its origins in the failure to propagate its own civilization. At best, the West can form political-diplomatic alliances, such as NATO, which can prevent a Soviet military victory. But the Communists know how to outmaneuver these traditional defenses. In order for the West to continue its existence as an independent civilization, it must conduct political warfare. And in order to do so, it must understand the basic principles.

II. An American Political Warfare Program

The question may be raised, "Can non-totalitarian countries conduct political warfare?" Is it not contradictory for them to impose their own civilization on other cultures? The answer may be framed as follows: every civilization is founded and maintained by what is now termed "political warfare," that is, the propagation of certain culturally based political concepts. A civilization is not a static affair. There is a certain ebb and flow to the areas it controls. There is constant interaction with other civilizations, and unless a civilization is able to propagate its

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concepts and values, it will be replaced by other, more dynamic, civilizations. The real question America must face isn't whether or not political warfare is a valid means of conflict. Rather, it is "Does America have the confidence to propagate its civilization?"

The current crisis in confidence over political warfare is all the more curious when viewed in terms of America's history. America has used political warfare as the foundation of its policies since its inception as a nation. The American Revolution was a political struggle for certain underlying political concepts concerning liberty, a struggle which defined the nature of the United States. The Declaration of Indepence is a fine example of political propaganda. It stated the political program of the revolutionary colonists. This was accompanied by a massive progaganda campaign both by individuals, such as Thomas Paine, and by Committees of Correspondence, which mobilized substantial elements of the populace. Indeed, American rebels pioneered many of the political warfare techniques which would become standard in the twentieth century – such as the exploitation of mob violence, leafleting, and guerilla warfare. These provided a dimension of conflict with which the more conventional British were not ready to cope.

Throughout the 19th century, the United States expanded through political warfare. With its underlying belief in Manifest Destiny, America as a civilization with the right and duty to expand across the continent bringing freedom and prosperity, was the political impetus for the westward march. American military and diplomatic services conducted political warfare in futherance of this civilizing objective. For example, prior to the War with Mexico, the United States consul in California propagandized among American settlers for a revolt against Mexico and union with America. In 1845 the American government sent Captain John Fremont with a scientific expedition to the then Mexican territory of California. On the outbreak of the war with Mexico, Fremont and his men led American colonists in a coup which took control of California and proclaimed the Bear Flag Republic, which was eventually annexed by the United States. Furthermore, other Army units, such as Stevenson's New York Regiment, were organized for political purposes. Stevenson's Regiment was sent to California to assist in

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the assimilation of the state into the Union.(13)

The United States conducted a successful counter insurgency in the Philippines following the Spanish-American War. It was able to do so because it followed the basic principles of political warfare. The United States had a long term political program based on granting independence upon the establishment of a viable Philippine government. This served to mobilize local support and cooperation with United States forces and undermine support for their opponents. The armed forces cooperated in this process by establishing schools to educate the populace in the American way of government, by programs such as health and sanitation training which improved the Philippino's way of life, and by establishing popularly-based paramilitary forces, such as the Philippine Scouts, to fight the guerillas on their own terms. The result of these policies may be seen in that the Philippines have remained a loyal ally of the United States throughout the Twentieth Century.(14)

This is, of course, only the briefest outline of American political warfare. Numerous other examples could be cited, such as the propaganda campaigns both sides conducted during the Civil War. The basic point is that political warfare has been an integral part of American strategy since the eighteenth century.

It can be seen, therefore, that non-totalitarian governments can conduct political warfare. The preservation of the independence of free nations throughout much of the world is, in fact, the direct result of political warfare campaigns. In one sense a nation will become involved in political warfare whether it desires or not. American concepts of freedom and industrialization have had an impact which has changed much of the world, whatever American intentions are. American television and motion pictures have spread more ideas about the United States than any government propaganda campaign could. The question isn't so much whether there will be propaganda. It is, who will direct the propaganda? And will that propaganda be part of an organized program or not? One should look beyond the forms of the struggle to the substance. What is critical is the civilization that results. The problem with American political warfare in recent decades isn't that it hasn't been conducted. The problem is that it no longer has as a unifying objective the propagation of Western values. If Americans believe in them-

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selves, if the West is better than Communism, then America must have a political warfare program. This will require the following steps.

Recognition of the nature of the struggle: The United States must realize that modern warfare is not simply a conflict between two military forces, but rather, a struggle between two political systems. This struggle is neither "war" nor "peace" in the traditional senses of the terms. The conflict is on another level and can be termed "protracted conflict," "cold war" or, for that matter, "political war." The label itself is not important. The critical thing is that America understands this conflict and is prepared to act.

The reason for this struggle is the radically opposite character of the ideologies which confront each other. The West sees political order in terms of nation-states, which represent the interests of the peoples within their own boundaries. The Communists see the political world order as an international class struggle: the class struggle takes place in every country, and the boundaries of countries are only artificial inventions of the ruling classes to keep the people divided. The Communists hold that it is their duty to assist in the class struggle of the "oppressed" against "exploiters" in all countries of the world. This is why the Soviets can sincerely claim their invasion of Afghanistan was a defensive action. They saw themselves as protecting the revolutionary classes of Afghanistan from counter-revolution. This is why they regard their support for national liberation movements as defense, and any Western action against revolution as aggression and imperialism. The Communist world view has radically different political foundations from the Western. Granted, this world view may not be "objectively" valid. It is valid solely in the context of Marxist ideology. Nonetheless, it exists. And as long as it exists, it will place the Communists in conflict with the rest of the world. It gives the Communists their political objective: the destruction of all other civilizations and replacement with their own. The West, presumably, desires to live under and preserve its own civilization. Therefore, it must be prepared to engage in the struggle. The only way for the struggle to end is for either the Communist or Western world view to be destroyed. This analysis has parallels, also, in the struggle now developing with the new challenge to Western civilization being posed by the New

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International Economic order and the ambition of the Third World – reinforced by its burgeoning population – which similarly seek to attain fruition at the expense of the West. For the present the Soviets attempt to exploit the new political force to their own goal – the destruction of the West – but it is nonetheless a separate ideology with a political power base different from that of the Soviets, and one which is fueled by growing demographic power.

All other actions have to be understood in terms of this struggle. The conflict over Grenada was not an isolated event. It was a battle in a greater campaign. The Soviets were attempting to gain control of the Caribbean through the establishment of a Marxist government on the island. The coup by militant Communists against the Marxist Bishop government was the consolidation of their political warfare campaign. The United States reacted correctly, invading the island, overthrowing the Marxist government and replacing it with a pro-Western administration. The United States was not "committing an act of aggression." It was defending against a Soviet offensive in the Western hemissphere. Similarly, all other political warfare campaigns, such as the War in Vietnam and the peace movements in Europe, cannot be understood as isolated events. They too are all part of the greater struggle.

This struggle cannot be ended by any of the methods of traditional statecraft. Negotiations will accomplish nothing, simply because there is nothing to negotiate. The problem is not "tensions" or "disagreements" or "misunderstandings." It is the underlying political systems. Since neither the Communists nor the West will negotiate away its own civilization, the cause of the conflict will remain. Will the Communists stop believing in the inevitability of the class struggle? Will the West abandon the freedom of its citizens? (Some might say that there is a danger of *this* happening!) Granted, minor issues might be settled, but the conflict will continue.

Unilateral halts to political warfare will accomplish nothing. The West has actually tried to "end the Cold War" by this method in the past. Following America's withdrawal from Vietnam, it cut support to the South Vietnamese and Cambodians resisting the Communists. The Communist response was the North Vietnamese offensive which conquered all of Indochina. Because the United States refrained from acting in the post-

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Vietnam era, the Communists seized power in Angola, Mozambique, Ethiopia and Nicaragua as well as increasing their revolutionary and propaganda activities worldwide.

Arming or disarming are also pointless in attempting to resolve the conflict. Since this is not a military conflict, increasing or decreasing the numbers of conventional or nuclear weapons will not by itself solve the problem. Increases in defense spending, or arms control talks, serve only as illusions that the conflict can be avoided by manipulating the material aspects of war. The problem is not solely one of a balance of power. It is a balance of politics. Any evaluation of the political conflict in traditional military terms is pointless. There are endless numbers of charts and studies by pro-defense groups which show the military line-up. Invariably these list numbers of weapons, combat units, firepower and so forth. Yet they ignore the real instruments of modern conflict. With how many nuclear weapons did Khomeini defeat the Shah, or seize the American embassy in Teheran? When will we see studies showing the numbers of propagandists, intellectual infiltrators, motivated publishing houses, radio broadcasting stations, and national liberation fronts operating in the service of the East and the West?

Political operations must be unified: All political operations need to be part of long range national plans which coordinate all elements of national policy. Something akin to a National Security Council level position is required to coordinate the direction of political warfare, and to coordinate the various political operations forces of the government. This should include a national staff for the planning of political operations. The problem isn't so much a lack of political operations forces, since there are numerous such forces scattered through government agencies and the armed forces. The problem is getting them to act together, with a clear appreciation of the problem, and clear goals, and with other agencies of national policy — military, diplomatic, economic.

All elements of national policy must be mutually supportive, not divisive. If the United States involves its military forces in a conflict, it must support them with propaganda. While the military forces win the military victory, the political forces must secure the political victory. Further, the United States must be willing to follow through militarily what it begins

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politically. If the United States supports insurgents against a Communist government, for example, then it must be prepared to intervene with its military forces, *if necessary,* to consolidate the victory. There can be nothing more futile than starting a revolution which we are not prepared to win.

The United States must make no secret of what it will be doing. America's goals must be clear: the defense of the nation and the defeat of its enemies. Americans must be made aware of the nature of the conflict in which their country is engaged. If America expects people to fight for it, then it must openly recognize it is participating in a greater struggle. Granted, there is need for secrecy in some operations. But restrictions which necessitate "covert" operations, which can never be associated with the United States, lead to serious problems. No one is certain as to what the United States is really doing. this damages credibility, since official statements and national policy are at variance. And what usually happens is that an enterprising journalist uncovers the operation, leading to embarrassment for the government. The opponents of American "covert" operations in Nicaragua have a field day in criticizing American efforts to support the *contras.* Since the United States is unable to admit its role, it loses any chance to conduct propaganda in support of anti-Marxist forces. Instead, it must flounder with official statements of non-denial. There are millions of people around the world who would rally to work with the United States in the defense of freedom, if only the United States could make its objectives clear and worked for these consistently.

Clearly people involved in political warfare must be trained in the field of propaganda development, political organization, guerilla warfare, and other aspects of the form of conflict, but it would be a mistake to turn this into an elitist field, restricted to specialists. Ultimately, political warfare requires from its participants a faith in the values for which they are fighting. A civilization must mobilize all those willing to fight for it. There is a place for the participation of a wide variety of citizens, ranging from journalists, teachers and students, to busnessmen and soldiers.(15)

Political warfare must take the initiative. It must put the enemies of the beleagured civilization on the defensive. Political warfare must build political systems which will have the

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strength to mobilize the people and to withstand the attacks of enemies. Taking the offensive would include such obvious policies as supporting insurgencies against enemy governments. But it can also include assisting friendly cultures and countries in building up their political infrastructure and implementing policies which will gain the support of their people.

Establishment of a political warfare program. Any political warfare program must have three general objectives: the propagation of loyalty to the traditional culture and political system; the targetting of the attacking culture and political system; support for sympathetic cultures and peoples around the world. For America, this means 1) the validation of free systems of government, and emphasis on the viability of its political principles, such as liberty and individual rights. These become premises which cannot be debated. America cannot allow its civilization to be on the defensive as the target of political attacks. There is nothing as ridiculous as the United States having to defend its own press from demands in the United Nations for a new world information order. If America expects people to fight for it, then its underlying concepts cannot be subject to ridicule, debate or recall. The Soviet exploitation of the antiwar movement has been based on the concept that there is nothing worth fighting and dying for. But by propagating Western standards as non-negotiable values it will establish that freedom is worth the struggle. This will also put the political and ideological enemies of the West on the defensive, as they will have to answer for their failure to measure up to the standards of Western civilization and explain why they are opposed to freedom.

At the same time, there must be an understanding that the types of political solutions that work in America will not necessarily work in other countries. A nation cannot become a free country overnight simply by granting one man one vote or legalizing opposition parties. For free governments involving public participation through free elections to be established in other countries there must first be an organized political movement which is able to mobilize the people for representative political proccesses. If America desires to support freedom it must be prepared to use the entire range of political operations to advance it.

2) The primary target of operations must be the targetted

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political system itself: it is pointless to engage in protracted military struggles trying to destroy the enemy's armed forces when the real problem is the political power structure behind those forces. Attempting to defeat an enemy without destroying his political system is futile, as Vietnam demonstrates. If the power structure remains intact then it will continue the struggle, regardless of the outcome of the military battles. In political warfare it is the antagonists' political power structure that is the real target, for this represents those who actually want the conflict. This attack against the political system can take several forms. The most obvious is that the organization can be broken up by effective security procedures. It can also be rendered ineffective by civil resistance which destroys the popular base for the organization.(16)

More importantly, the ideological foundations of the enemy's political power base must also be destroyed. What makes Marxism such a threat is not its material assets. It is the beguiling militancy of Marxist-Leninist ideology. It is the insidious nature of the ideology which provides the moral impetus for revolution, with its insistence on the historical inevitability of world revolution. If this ideology were to be discredited then the underlying ideology used to justify Soviet aggression and to rally popular support for it would no longer exist. Attempts at so-called "national liberation" – aimed really at the destruction of existing national freedom and incorporation of "liberated" peoples into a faceless, Soviet-style world order, would lack all pretense for moral justification. If Marxism were to be discredited as an ideology, then it would no longer have the power to mobilize people for revolution.

At the same time, the West must defend itself internally from enemy political warfare attacks. The Soviet political warfare apparatus now operating in the West must be identified, exposed and legally suppressed. This widespread apparatus is not participating in American freedom, but is vigorously striving to destroy it. The Soviet political warfare apparatus is just as much an invasion of the West as the Soviet armed forces would be if they were to cross the borders. It is utterly futile to attempt to defeat the Soviet Union in Afghanistan if we are unable to defend ourselves against it in America. Since America's own political warfare services are forbidden by law from operating within the United States there can be no justification

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for allowing the enemy to operate freely an American territory.(17) Yet few would doubt that Soviet-backed Marxist ideological bias and disinformation is deliberately insinuated into the American media, and into the American educational system, even into the American political process, to a very extensive degree.

It is not enough to defeat the enemy's planned system of disinformation and ideological distortion. This must be replaced by truth and value systems that will be immediately recognized as better.

3) *Support for Western cultural values and political systems:* The United States must support those peoples who seek to defend the West, worldwide. The United States is a part of Western civilization. That which strengthens the West strengthens the United States. The United States should support those thinkers and activists who seek to overthrow tyrannical anti-Western governments. It must do so with all elements of political warfare. The United States could become the center of an alliance of free world National Liberation movements fighting for their freedom against totalitarian Marxist tyranny.

But, it will do no good to overthrow a Communist government if it is replaced with another goverment that is just as hostile to Western civilization. There has been much consideration recently about supporting the supposedly anti-Soviet population of Asia, such as the People's Republic of China, and some of the Moslem ethnic groups within the USSR. But would these be wise tactics in the long run? Or would we merely be building up forces that would become as hostile to the West in the course of time? Would totalitarian Mainland China, hungry for Western technology, be a reliable ally? Would a victorious militant Islam in Central Asia remain allied to the West? If history is to be learned from, one should re-examine the Russian Revolution. The German General Staff supported Lenin's Bolsheviks against Kerensky's revolutionary government to take Russia out of World War I. While Lenin's revolution was advantageous to Germany in the short run — a very short run, one might add — in the long term it was a disaster since it gave the revolutionists a base for their climb to world power. Today two-thirds of the Kaiser's Germany are under Soviet dominated Communist rule, the eastern portion is included within the fron-

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tiers of Communist enslaved Poland and the central portion comprises that Communist tyranny known to us as "East Germany."

This means that prior to supporting any revolutionary movement, its objectives must be analyzed. Those that are inherently Western, such as the East European freedom fighters, should obviously be supported. A successful revolution by them against the Soviets would hopefully lead to the re-establishment of free European national states in Eastern Europe. Supporting any modified form of Marxist movement would be a mistake, since Marxism is inherently opposed to the heritage of Western civilization. While there might be a seeming tactical advantage in assisting Marxist insurgents against a Communist government (such as the blood-soaked Khmer Rouge against the Vietnamese in Cambodia) if such clients are victorious, then one enemy has been replaced with another. Of course, there are numerous insurgent movements in the non-Western world which may be supported as long as they are not inherently inimical. Indeed by supporting such civilizations the freedom of the West may be strengthened, as their struggle for freedom and independence becomes interlocked with our own.

At no time should the United States fall into the trap of opposing other Western nations simply to gain a diplomatic advantage. The United States made a critical mistake in opposing the British and French 1956 Suez invasion. Apart from the fact that Britain and France sought to defend valid treaty rights over the Suez canal, the U.S. support for Egypt meant that any favor gained by the U.S. with Nasser was more than outweighed by the loss of Western status and Western strategic interests in the Middle East. A united Western front on this matter would have meant the retention of the Suez Canal as well as Western dominance in the area and, possibly, the collapse of the anti-Western Nasser. The enemies of the West thereafter exploited the lack of unity of the Western states by effective propaganda campaigns. They have placed America on the defensive for supporting states such as South Africa or El Salvador, which are less than perfect democracies. Enemy propaganda uses the rhetoric of democracy, and talks consistantly of "people's struggles for freedom", of "anti-colonialism", "self-determination" and "majority rule". In reality, these

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struggles have nothing to do with democracy. Rather, they are conflicts between Western civilization and non-Western totalitarian systems and cultures. This may be verified by examining recent history. The result of virtually every revolution by Communists, anti-colonialists or anti-Western forces has not been the establishment of democracy, but rather, the destruction of whatever democratic institutions once existed under Western influence. Democracy is not a natural condition of mankind. This has been the great error of post-World War II American policy. It was assumed that all it took to promote human dignity and individual freedom was remove an oppressive government, declare the establishment of a democracy and hold elections. The Western system of constitutional representation or participatory government is a political system which evolved over centuries and has been to be successful in the Western countries because it is a part of the total cultural tradition of Western civilization. Like any other political system it can only be maintained if supported by a deep-rooted belief system.

Any hope for representative government in Rhodesia was lost when Ian Smith's European dominated government turned power over to the African based national liberation movements. If European domination had been maintained, then in the long term a broadly based democratic type of state might have developed, as the African population assimilated these traditions, inheriting, as they already did, a kinship based tradition of village debate and politics by consensus. But with the impetus for this gone, Zimbabwe now moves toward a one-party state and Marxism. The struggle in Rhodesia was not between a repressive colonial government and the forces of majority rule, but rather between those Rhodesians, white and black, who believed in the Western system, and those who believed in totalitarianism and Marxism. But such has been the victory of anti-Western propaganda that it has managed to convince the West that the collapse of Rhodesia was a victory for democracy!

The Western nations cannot allow itself to be deluded by such propaganda in the future. If it does, then it will see what still remains of Western influence in the Third World destroyed by the forces of "majority rule". The United States must take the political offensive to support those countries which still have something of the Western tradition of civilization. Rather than apologizing for these values in international forums,

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America must place their attackers on the defensive with a propaganda campaign that treats an attack against one free pro-Western state as an attack against all. They must be assisted in developing politically viable systems which can mobilize non-Western populaces against attempts by the Marxist powers to subvert them to the revolutionary cause. The ultimate result will be the establishment of an international Western political alliance which can defend Western civilization on the political warfare level.

The Western nations must face a fundamental reality. If they wish to protect their own freedom, or the freedom of other peoples and civilizations around the world, then they must conduct political warfare. This will give America and the West the initiative and reverse the advance of totalitarianism. America and the Western nations have the material capability for political warfare. All they need is the will – and reliable, clearsighted personnel – to employ it.

FOOTNOTES

(1) For a complete description of modern political warfare, see my article "Political Warfare: the Decisive Strategy" in the Winter 1984 issue of *The Journal of Social, Political and Economic Studies.*

(2) Sir Robert Thompson, *Peace Is Not at Hand* (New York: David McKay Company, 1974), pp. 50-53.

(3) William Daugherty, *A Psychological Warfare Casebook* (Baltimore: Jonhs Hopkins Press, 1958), pp. 15-16.

(4) Daugherty, p. 138.

(5) Sig Mickelson, *America's Other Voice* (New York: Praeger Publishers, 1983), p. 156.

(6) Roy Goodson, ed. *Intelligence Requirements for the 1980's: Covert Action* (Washington, D.C.: National Strategy Information Center, 1981).

(7) William Colby, *Honorable Men,* (New York: Simon and Shuster, 1978), pp. 108-116.

(8) Ray S. Cline, *The CIA Under Reagan, Bush and Casey* (Washington, D.C.: Acropolis Books, 1981), p. 155.

(9) Ibid.

(10) Andrew Tully, *CIA: The Inside Story* (New York: William Morrow and Co., 1962), pp. 163-168.

(11) Colby, p. 195.

(12) Charles M. Simpson, *Inside the Green Berets,* (Novato, California: Presidio, 1983), pp. 69-85.

(13) Donald C. Biggs, *Conquer and Colonize* (San Rafael: Rresidio Press, 1977).

(14) Daugherty, pp. 585-586.

(15) James Burnham, *The Coming Defeat of Communism* (New York: The John

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Day Company, 1950), pp. 243-244.

(16) Sir Robert Thompson, *No Exit from Vietnam* (New York: David McKay Company, 1970), pp. 165-167.

(17) James Burnham, *The Struggle for the World* (New York: The John Day Company, 1947), pp. 203-210.

(18) See, for example, Chester Bowles, *African's Challenge to America* (Berkeley: University of California Press, 1957).

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MONOPOLY POWER, TAXATION, AND ENTREPRENEURSHIP

By E.C. Pasour, Jr.

> "The entrepreneurial function, the striving of entrepreneurs after profits, is the driving force in the market economy....If the methods of taxation...restrict the accumulation of new capital, the capital required for marginal employments is lacking...The wants of consumers are satisfied to a lesser extent." *von Mises* (1)

Investment in capital goods hinges on expected productivity and profitability. Although capital formation in the United States receives a great deal of emphasis in both the business community and the financial press, the role of profits in the conventional neoclassical theory of the firm is not consistent with the importance of expected profits in investment decisions. When the norm of "perfect competition" is used as a benchmark, any firm facing a less than perfectly elastic demand is considered to be producing "too little." In this approach, profits are considered to be "economic rents" serving no beneficial purpose.(2) The focus of public policy is then on taxation, marginal cost pricing, and other economic regulation schemes to improve resource allocation.

Insights from the entrepreneurial market process approach provide a much different perspective on competition and monopoly. Specifically, competition is concerned with entrepreneurial behavior or how firms act, and the competitive market is considered to be a *process* directed by profit and loss signals rather than a situation where demand is perfectly elastic. Returns commonly labelled "monopoly profits" might more appropriately be viewed as returns to entrepreneurship rather than "economic rents" serving no useful function in this nonequilibrium approach, which stresses the importance of entrepreneurship.

The major purpose of this article is to describe the adverse effects of taxation and other economic regulations on the entrepreneurial market process. The limitations of the concept of monopoly and monopoly power in conventional neoclassical theory are first described. Monopoly power is then related to entrepreneurship – the driving force of the market economy. Problems of identifying examples of resource misallocation and

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entrepreneurial inefficiency under real world conditions of uncertainty and imperfect information are stressed. Entrepreneurial profit is contrasted with "economic rent," and it is shown why taxes on "windfalls" and other profits adversely affect entrepreneurial incentives. Since profits and losses are the best indicators of how well producers have accommodated consumer demands, it is argued, taxing profits is equivalent to taxing success in best serving the public. Finally, it is held that there are ethical as well as economic reasons for reducing the role of government, including restrictions on entrepreneurship.

The policy implications of the analysis for taxation and capital formation are shown to be straightforward. Taxation adversely affects entrepreneurial profits and, consequently, investment and capital formation. The entrepreneurial market process approach, however, reveals that capital formation hinges not only on taxation and expected profitability but more broadly on market coordination. Since the production process occurs over time, intertemporal plan coordination is necessary for savings to be converted into the most highly valued investments. Expected product and input prices, profits, and interest rates are all considered to be important in this coordination process. Consequently, the importance of political and economic conditions that hamper increased entrepreneurial activity is stressed.

Monopoly in Conventional Neoclassical Theory

Monopoly in conventional theory is viewed as a market *situation,* but there is no consensus as to what that situation is. For Friedman and Becker, monopoly is taken to be a situation where demand is not perfectly elastic.(3) Glahe and Lee define monopoly as a situation in which there is a single seller of a product for which there are no close substitutes.(4) Hirshleifer considers monopoly to be the situation that exists when an industry consists of a single firm.(5)

In this traditional neoclassical approach, monopoly power may arise from several sources. Economies of scale is perhaps the most widely discussed basis of monopoly power. However, the theory of the so-called "natural monopoly," where average cost of production falls throughout the relevant region of output, presupposes a problem, at least to some extent, by assuming both large economies and the lack of good substitutes.

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Increasingly, questions are being raised about the practical significance of the "natural monopoly" as a source of monopoly power. First, Demsetz argues that the competitive result can be obtained through bidding by rival producers even if there are economies of scale so that production of the good or service is limited to a single firm.(6) This argument holds that scale economies in production need not lead to "monopoly power" in the market place if the productive inputs are available to many potential bidders and rival producers do not collude. Entrepreneurial competition can be expected to eliminate "excess profits" as long as entry does not depend on prior possession of a particular resource. The problem of rebidding when a firm has capital facilities in place, however, raises questions about the feasibility of this bidding approach. Moreover, if government selects only one supplier for a particular service, there is an incentive for firms to engage in bribery and other "rent-seeking" activities and for public officials to respond.

Second, regardless of the feasibility of the Demsetz proposal, it is increasingly becoming clear that direct competition is feasible in the case of many services traditionally labelled "natural monopolies." In more than 20 cities throughout the United States, for example, producers now face direct competition in providing electric utility services.(7) Savas cites evidence that private companies relative to government agencies can provide firm protection, mail service, garbage collection, health care and many other services at lower cost.(8) Such results raise questions about the theory of "natural monopoly" as a basis of monopoly power and the rationale for "public utility" regulation.

Restrictions on the access to productive factors is another alleged basis of monopoly power. The control of oranges, for example, might be expected to give a firm a monopoly position in the production of orange juice.(9) However, two questions immediately arise in the case of an alleged resource monopolist. first, how would a producer achieve such a position? The conventional wisdom appears to be erroneous concerning perhaps the most frequently cited historical example of monopoly based on control of inputs. The Aluminum Company of America (Alcoa) is alleged to have "controlled practically every source" of bauxite essential in the production of aluminum.(10) In fact, Alcoa owned less than half the bauxite in the United States at

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the time, and the supply outside the U.S. was found to be "practically inexhaustible."(11)

The Aloca example illustrates the problem facing any would-be-monopolist – the problem of limiting entry and eliminating domestic and foreign competition. How would a producer of orange juice, for example, obtain control over oranges. The cartel model suggests that the free-rider incentive is likely to cause participating firms to cheat on agreements to restrict competition. Each firm has a financial incentive to secure an agreement to reduce sales in the aggregate and then to secretly break the agreement – to "free ride" on the other members. The orange example is a timely example of the approach commonly used by producers to achieve and maintain monopoly power. Orange producers in California are able to control the market flow of fresh oranges only because oranges are marketed under federal marketing orders – a legalized cartel system that uses the sanctions of government to suppress the free-rider incentive of domestic producers and importers. Without such sanctions voluntary cartel arrangements are typically short-lived.

There is also another shortcoming of resource control as a basis of monopoly power. If resources are defined narrowly enough, every producer has a resource monopoly – including Grandma Moses (the artist) on the power of the corner drug store. Yet, it is obvious that such resource monopolies do not imply harmful monopoly power in any meaningful sense. There are good substitutes for the services of the corner drug store or for the paintings of Grandma Moses.(12) Consequently, it is important to distinguish monopoly power arising from government intervention from the so-called "monopoly power" by firms that face less than perfectly elastic demand curves achieved through entrepreneurial alertness. This distinction is generally not made in conventional neoclassical theory.

The orthodox view holds that monopoly involves resource misallocation because output is too small. In the example of the price searcher depicted in Figure 1, output is said to be reduced from OQc to OQm and price is increased from OPc to OPm. The alleged inherent inefficiency of monopoly involves a "transfer" of area A from consumers to producers (Figure 1). The efficiency loss of area B, the "welfare cost" or "deadweight loss," is due to the decrease in "consumer surplus" arising from

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the lower quantity of output (OQm rather than OQc). Thus, the monopolist is said to produce "too little" and to change a price that is "too high" when contrasted with perfect competition. Monopoly in the situation depicted is deemed to be socially harmful because it leads to output restriction and price that is higher than marginal cost.(13)

The presumed monopoly equilibrium depicted in Figure 1, however, will not withstand critical scrutiny. The seller may take advantage of unexploited profit opportunities through price discrimination as long as price exceeds marginal (opportunity) cost. Opportunity cost includes all relevant outlays including production, marketing, and transactions costs. In Figure 1, price charged exceeds the marginal cost at the presumed equilibrium, OQm. From the decision maker's standpoint, output will be increased until price is driven to cost. Thus, if the cost and revenue conditions depicted are accurate, OQm is not an equilibrium output, and if OQm is an equilibrium output, the cost conditions must be other than those depicted in Figure 1. Consequently, in the situation depicted in Figure 1, there is either no monopoly or no equilibrium.(14)

In conventional analysis, the assumed transfer (area A in Figure 1) is considered to be a Ricardian economic rent — a return performing no useful economic function. If this is correct, it follows that "A lump sum tax must be borne entirely out of the monopolist's profit."(15) In this approach, all traces of monopoly represented by less than perfectly elastic demand are branded socially harmful, and it is held that "monopoly profits" can be taxed away without adversely affecting resource allocation or the production process.

There are at least two problems with the approach just depicted. First, if every firm facing a negatively sloped demand curve is regarded as having a monopoly, many sellers operating under competitive conditions (under any practically meaningful definition of the term) will be erroneously classified as monopolists — including the 10-year-old entrepreneur operating a lemonade stand. Buyers of a particular product lack alternatives only if demand is perfectly inelastic. Since there are substitutes for *all* goods and services, however, no seller faces a perfectly inelastic demand. Thus, since closeness of substitutes is a matter of degree, any demarcation concerning how inelastic demand must be for the seller to be considered a monopolist

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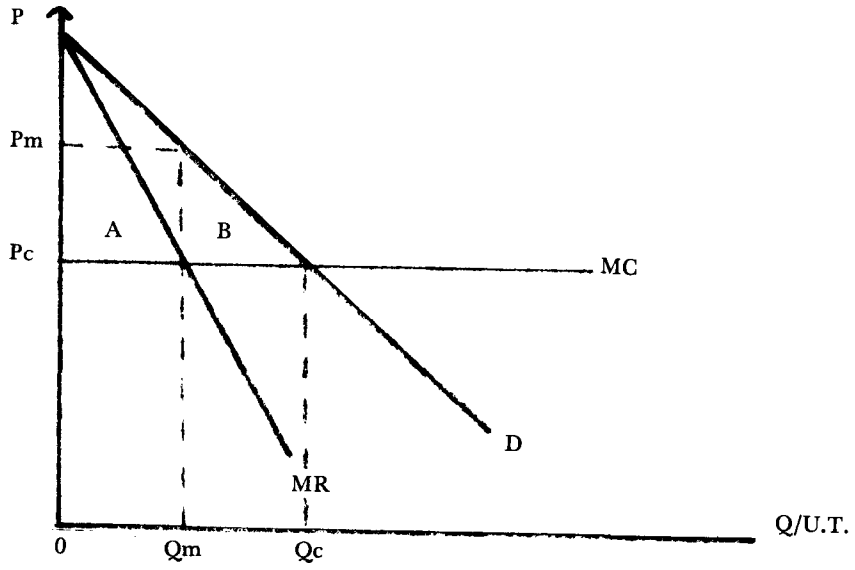

Figure 1. Monopoly — equilibrium price and output in the conventional approach

is purely arbitrary. A second and even more fundamental reason why production is now socially harmful when demand is less than perfectly elastic is emphasized in the market process approach.

Monopoly and Entrepreneurship in the Market Process Approach

In the conventional long-run equilibrium framework typically used to analyze monopoly, all profit is due to monopoly. In long-run equilibrium the decisions of all market participants dovetail perfectly. There are no opportunities for gain and, consequently, neither profits nor profit opportunities. Under these conditions, profits perform no useful function. The equilibrium framework, however, is inconsistent with the nature of a market system fueled by expected profits.(16)

The alternative suggested by the Austrians is to view monopoly as an impediment to the market process. The existence of high profits by one firm (or many firms) will attract competing producers as long as there are no impediments to entry. Thus, the central theoretical issue to be solved by any monopoly theory is the entry problem.(17) In this view, competition is a *process* and the lack of effective market competition (or the presence of monopoly) is not because a particular market situation (perfectly elastic demand or a large number of firms) doesn't prevail. It hinges instead on something that prevents market participants from competing in the market.(18) Restrictions on competition other than those of a short-run nature, however, are almost invariably the result of government intervention.(19) Thus, it is argued here, the unhampered market tends to be a competitive market and competition in the market process sense is likely to be present as long as there exist no arbitrary state-imposed impediments to entry.

The entrepreneurial profit and loss approach places conventional monopoly theory in a new light and raises a key question. If a seller achieves a supra-normal profit, why does the entry of new firms not occur? If, as Kirzner suggests, entrepreneurial activity is always competitive, one would expect entry as long as there are economic incentives and entry is not legally restricted.(20) Although the individual entrepreneur may achieve an "above-normal" rate of return in the short run, competition erodes the advantage, given time for adjustment

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and freedom of entry by other firms.(21) That is, in an unhampered market there is an inherent tendency over time for profits (and losses) to disappear.

Another shortcoming of conventional monopoly theory is that it does not fully reflect the nature of the entrepreneurial market process. Where monopoly power is not the result of government intervention, the welfare consequences of monopoly cannot be appraised strictly in terms of the immediate allocation of resources. A downward sloping demand curve doesn't necessarily imply a harmful restriction on output when the nature of the competitive entrepreneurial process is taken into account. A particular firm may acquire a short-run advantage over competing firms through earlier entrepreneurial alertness or ingenuity. Consequently, entrepreneurial profits may be due to an awareness of arbitrage opportunities in time or space or they may arise from the development or sale of a new product. Olson, in a recent study of the effects of specialized pressure groups, suggests that above-normal short-run rates of return due to innovation are of crucial importance in economic growth and progress.(22)

The preceding discussion suggests a shortcoming of the long-run competitive equilibrium model in identifying or measuring "monopoly profits." The role of profits in stimulating entrepreneurial activity is ignored since all profits are necessarily monopoly profits.(23) Thus, this approach, which allows no scope for beneficial profits, fails to recognize the crucial role of profits in the market system.(24) Profits, in reality, provide the entrepreneurial incentive to produce goods and services consumers must urgently want and to direct resources into the hands of those most competent in producing and bringing goods to market. Moreover, since profits and losses reflect the success or failure of the entrepreneur in adjusting production to consumer demand, profits in a competitive industry can never be said to be "too high" or "too low." In the words of Rogge: "The abnormally high profits in some industries are the signals that consumers are calling for more firms to enter those industries. The below-normal profits or outright losses in other industries are the signal that consumers are calling for some firms to get out....The above-normal profits then are not 'too high' in any value sense, nor are the below-average profits 'too low.' They are simply signals and very, very important signals

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as well."(25)

The entrepreneurial market process approach, in contrast to that of long-run competitive equilibrium, stresses the necessity of using a model that permits above-average returns to entrepreneurship. The relevant alternative to output OQm in the situation depicted in Figure 1 may not be OQc but rather no output at all – at least during the time period under consideration. Consequently, the entrepreneur's action in producing the product is likely to generate a *social gain* rather than a social cost.(26) It is inappropriate and inconsistent with the very nature of the competitive market process to consider returns to entrepreneurship as socially harmful.

The view of the market as a competitive process stresses the importance of taking a longer run view of what from a shorter run view may appear to be excessive profits or lesses and also suggests that the most meaningful way to define monopoly is as a governmental grant of special privilege.(27) If one considers the important cartels in the United States today, virtually all are rooted in government power. Occupational licensing, restrictions on imports of autos and steel, agricultural marketing orders and other agricultural price support programs, labor cartels, the Post Office, and various firms operating under government franchise are examples of state-sanctioned and enforced restrictions on competition. Government restrictions on entry in these and other areas have the effect of stifling initiative and the creative discovery process of the competitive market. Yet, discussions of monopoly profit seldom distinguish profits due to entrepreneurship from profits rooted in state power. The failure to make this distinction appears to be closely related to the general neglect of entrepreneurship in neoclassical theory.

The entrepreneur is seldom encountered in neoclassical theory as presented in economic theory tests.(28) In the words of Baumol, "The theoretical firm is entrepreneurless – the Prince of Denmark has been expunged from the Discussion of Hamlet."(29) Kirzner suggests that the neglect of entrepreneurship can be traced to the general preoccupation of neoclassical theory with final equilibrium positions.(30) The focus on equilibrium masks the role of the entrepreneur, since the plans of different individuals are mutually compatible when markets are in equilibrium.(31) Stated differently, the decisions of all

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market participants dovetail completely in equilibrium so there is no scope for profit-seeking entrepreneurship. There is no explanation of how market participants obtain the knowledge required – it is merely assumed that information and transactions costs "are such as to provide the conditions that are required for economic equilibrium."(32)

In the conventional Robbinsian approach to the theory of the firm, entrepreneurial problems are largely assumed away. It is implicitly assumed that the decision maker has the necessary information on costs and returns of alternative production stragegies – that is, means and ends are assumed to be *given*. In this approach, where the entrepreneurial problem consists of selecting from among known alternatives, entrepreneurship is reduced to calculation.(33) In the real world, of course, the entrepreneur is *not* given information on means or ends, and the decision maker must deal with the uncertain future.(34) In this setting where all decisions are shrouded in uncertainty, entrepreneurial mistakes are far more likely to be due to an erroneous assessment of present and future conditions rather than to errors in calculation.(35)

As suggested above, there are no entrepreneurial opportunities when markets are in equilibrium. The real world decision making arena, however, is one of disequilibrium – a situation characterized by incomplete market coordination, which gives rise to profit opportunities. That is, since the decisions of market participants never perfectly dovetail when economic conditions are constantly changing, alert entrepreneurs are able to perceive or create new market opportunities that have not been noticed or taken advantage of by other decision makers.(36) Thus, the competitive market process is set in motion by disequilibrium conditions.

There is no consensus about the nature of the entrepreneurial process. Kirzner considers the entrepreneur important in moving markets toward equilibrium by discovering and profiting from arbitrage across markets.(37) In this view, the entrepreneur is not required to own any productive resources; there *is* the necessity, however, to be alert in perceiving and exploiting price difference. In contrast, the entrepreneur is a disequilibrating force in the Schumpeterian analysis. Temporary monopoly profits are the rewards to entrepreneurs who introduce successful innovation. It is a basic premise of Schumpeter's

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analysis that such rewards are necessary to induce entrepreneurs to engage in innovative activity. Indeed, this is the economic logic of the patent system – a state-imposed restriction on competition.(38) Olson, also stressing the importance of innovation in economic progress, suggests that an innovative firm may achieve short-run profits from innovative activity regardless of whether it has "monopoly power." Thus, it is argued, entrepreneurial profits are socially beneficial whether or not the seller is a price taker and regardless of whether entrepreneurial activity is equilibrating.

It is significant that the theory of perfect competition and market equilibrium is rooted in the assumption of perfect knowledge. In the market process approach, in contrast, emphasis is placed on how information is brought to bear on decisions by market participants and how it directs relevant information to those who make the best use of it. In this sense, then, the competitive market is a discovery process.(40) Different people have different information about production and market conditions, and markets enable individuals to communicate this information to other people and to learn about information that other people have. The "economic calculation debate" of the 1920s and 1930s was fundamentally about the importance of decentralized markets in organizing production.(41) Since that time, a great deal of effort has been spent analyzing the efficiency of competitive markets. Economic efficiency has a well-defined meaning based on the norm of perfect competition. However, as shown in the following section, the competitive norm is of little (if any) value in identifying inefficiency under real world conditons of uncertainty and costly information.

Perfect Competition and Monopoly Waste – Measuring Inefficiency

Efficiency in welfare economics is defined in terms of the competitive norm. Perfect competition assumes price-taking behavior in buying and selling and "perfect markets" – including perfect communication, instantaneous equilibrium, and costless transactions.(42) No real world market, of course, can match this "ideal." Thus, real world markets will *always* fall short when measured against the competitive norm. Price taking, for example, implies that demand is perfectly elastic.

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Yet, as suggested above, many sellers operating under highly competitive conditons will be considered "imperfectly competitive" on the basis of this criterion. Thus, when perfect competition is the benchmark, monopoly profit, monopoly power, and resource misallocation inevitably will appear to be serious problems in real world markets.

Similarly, the stress on the "perfect market" masks the real world contribution of individuals who would have no role to perform in "perfect markets." If there were perfect communication, for example, there would be neither the need to advertise nor a role for advertisers. Similarly, if there were no transactions costs and markets achieved instantaneous equilibrium, neither middlemen nor speculators would have productive roles. Uncertainty and imperfect information, however, are features of all real world markets. Demsetz has labelled the procedure of comparing existing imperfect arrangements with an unattainable ideal, the "nirvana" approach.(43) Thus, although analytically useful for some purposes, the competitive norm is not appropriate for evaluating the economic efficiency of real world activities.(44) Furthermore, no one has discovered an appropriate benchmark for evaluating the efficiency of actual entrepreneurial decisions that are necessarily rooted in uncertainty and imperfect information. It is clearly inappropriate, however, to use a model that assumes away problems facing the entrepreneur in assessing entrepreneurial efficiency.

Economizing in the use of information is an important problem in entrepreneurial decisions. Whether it is economic for an individual to acquire more information before acting hinges on expected costs and benefits. The rational decision maker will attempt to acquire additional information only as long as the expected benefits exceed the costs.(45) What are the implications for measuring efficiency? The cost of any action is the value of the highest sacrificed alternative, and the value placed on the foregone alternative never actually experienced is inherently subjective.(46) Consequently, the outside observer cannot measure choice-influencing opportunity costs. This means that in making empirical efficiency measurements, the outside observer's own standard of value must be imposed to identify waste in the actions of other people.(47)

There is an important distinction between the *existence* and the *measurement* of inefficiency.(48) The subjective nature of

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data upon which decisions are based means that outside observers cannot identify and measure inefficiency on the part of others. This does *not* imply that there is no scope for improvement on the part of individual decision makers. Kirzner defines an action as inefficient if the entrepreneur places himself in a position viewed as less desirable than an equally available state.(49) Inefficiency from this standpoint implies an error or incorrect move in the sense that the decision maker fails to notice profit opportunities. We can be confident that genuine opportunities exist because the decisions of market participants are never perfectly coordinated.(50) The problem of measuring waste and inefficiency is closely related to that of windfalls and taxation addressed in the following section.

Windfalls, Taxation, and Capital Formation

The view of the market as a competitive entrepreneurial process, as suggested above, casts a different light on the role and importance of profits. If long-run equilibrium is used as a benchmark, all observed profits are due to monopoly, are considered to be permanent, and imply a welfare loss. In marked contrast, the entrepreneurial profit and loss approach stresses th importance of profits and the importance of taking a long-run view of what may seem from a short-run perspective to be excessive profits.(51) A major function of profit is "to shift the conrol of capital to those who know how to employ it in the best possible way for the satisfaction of the public."(52)

The treatment of profits in the long-run equilibrium framework reflects the neglect fo the entrepreneurial aspects of productive activity.(53) Moreover, if entrepreneurs are risk averters, what appear to be "unreasonably" high returns to the lucky or insightful may be necessary to evoke high levels of entrepreneurial activity.(54) Stated somewhat differently, what often appear to be excessive profits "provides the bait that lures capital on to untried trails."(55)

The profits of entrepreneurs who are most successful in coping with changing economic conditions cannot be taxed without adversely affecting entrepreneurial incentives and resource use. That is, taxes on "windfall profits," "speculative profits," and so on, will inevitably hamper entrepreneurial activity. Consequently, taxation reducing entrepreneurial returns is tantamount to an attack on the means used to cope

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with economic change. Taxes on entrepreneurship often come in disguise as in the case of the Carter Administration's so-called "windfall profits" tax on the oil industry. In a dynamic economy, however, "windfalls" are the norm rather than the exception and are closely related to property rights and entrepreneurial expectations. Property rights, in a broad sense, refer to the entire set of people's expectations about what they can and may do.(56) A windfall, defined as the difference between the outcome expected and that actually realized, is commonly associated with pure luck. However, profit achieved by predicting the future more accurately than others is not a windfall but a return to entrepreneurship. Moreover, in reality there is no objective way to separate windfalls from profits due to entrepreneurial skills. Was the individual who invested in the petroleum industry in the early 1970s, for example, farsighted or merely lucky? In a market economy, the entrepreneur can expect to reap the rewards if future economic conditions are favorable and to bear the losses if economic conditons prove to be unfavorable. In the haste to tax windfalls, it is often forgotten that windfalls may be losses instead of gains. If entrepreneurs expect that losses will not be subsidized and profits will be taxed away, they have incentives to minimize risk.(57) Thus, any tax on windfalls is tantamount to an attenuation of property rights and will inevitable adversely affect entrepreneurial incentives.

The conclusion that there will be less risk taking and innovative activity with an increased expectation that any future windfalls be taxed away implies that the supply of entrepreneurial activity is upward sloping – the higher the expected return, the greater the amount of entrepreneurship. Conversely, the lower the expected return (e.g., due to taxes), the lower the amount of entrepreneurial activity. This view that entrepreneurship is a function of expected profitability is inconsistent with statements frequently made during the past decade suggesting that taxes levied on "windfall profits" of oil firms would not adversely affect production. "Monopoly profits" or "windfall profits" cannot be distinguished from entrepreneurial returns and, consequently, are *not* Ricardian economic rents. Economic rents, as conventionally defined, can be taxed away without adversely affecting production.(58) In contrast, taxes on profits arising from competitive entrepreneurial activity will

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inevitably have an adverse affect on resources allocation and entrepreneurship.

Entrepreneurial profits may be taken as the best indicator of the extent to which the decision maker has anticipated and accommodated the demands of the market. Even if entrepreneurial profits are due to luck rather than foresight, the end result of the entrepreneurial activity is no less beneficial. In the words of Mises: "Specific entrepreneurial profits and losses are not produced by the quality of physical output....What produces them is the extent to which the entrepreneur has succeeded or failed in anticipating the future – necessarily uncertain – state of the market."(59)

In summary, if it is acknowledged that the supply of entrepreneurial activity is upward sloping, it follows that taxes on entrepreneurial profits adversely affect resources allocation and capital formation. A recognition of the crucial nature of the entrepreneurial role in the market process means that the quest for a neutral tax is futile. That is, a tax that will leave the market exactly the same as it was without taxation "must always be a chimera."(60) Under real world conditons, no tax can be neutral; every one will affect entrepreneurial incentives and decisions.

Inflation and Entrepreneurial Activity

The interaction of the tax laws and inflation can be devastating for entrepreneurial activity. During the past decade, the corporate sector in the United States has been taxed at nominal rates up to 46 percent and individuals at rates up to 70 percent.(16) After taking inflation into account, however, the real tax burden on capital frequently has been greater than 100 percent.(62) One important factor has been the bracket creep associated with progressive income tax rates. During the 1970s even when workers received pay raises enough to offset inflation, real after-tax wages often decreased because of bracket creep. Whereas only 3 percent of U.S. taxpayers faced marginal tax rates of 30 percent or more in 1960, by 1981 34 percent of taxpayers were in the 30 percent (or higher) tax bracket.(63) Real tax burdens, on average, increased about 15 percent from 1975 to 1981 as a result of bracket creep.(64) The interaction of tax laws and inflation during the past decade also lead to earnings being overstated because of understated depreciation

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expenses, since depreciation for tax purposes is based on the original purchase price rather than opportunity cost. Thus, in view of bracket creep, overstated earnings, and public policies that decrease savings, it is not surprising that there was a relatively low level of saving and investment during the 1970s.(65) Moreover, increased government regulation has also increased costs and reduced the expected profitability of business activity. Such regulations are, in effect, hidden taxes on business enterprise.

At a time when there is widespread concern about unemployment and the competitive position of U.S. industry, the relationship between capital formation and productivity warrants additional emphasis. In the words of Mises, "There is only one way that leads to an improvement of the standard of living for the wage-earning masses, *viz,* the increase in the amount of capital invested."(66) There can be little doubt that the rate of capital formation in the United States during the past decade has been adversely affected by taxes, inflation, and government regulations.(67)

Market Signals, Saving, and Capital Formation

In the entrepreneurial market process, where expectation of gain is the propelling force of action, capital formation hinges on savings and productive investment.(68) In this profit and loss system, information is coordinated and transmitted through the price system, which helps ensure that the right things will get produced. Prices provide accurate signals to consumers and producers, however, only when prices are free to change in response to changing economic conditions. When price supports raise prices of agricultural products above the market clearing level, for example, producers are encouraged to produce "too much," whereas consumers are induced to consume "too little" at the artificially high price. Such programs not only increase domestic production but also inhibit shifts in production between different production regions. In this sense, price controls served to stifle the discovery process of the market.(69)

Similarly, expected profits provide incentives for entrepreneurs to use effectively the information conveyed by prices. As suggested above, however, entrepreneurship isn't an either or phenomenon — instead, the amount of entrepreneurial activity hinges on the expected profitability. Therefore, an increase in

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taxes, *ceteris paribus,* inevitably has an adverse impact on profitability and, hence, induces producers to produce "too little."

Consider next the relationship between entrepreneurship and saving and the implications for capital formation. Saving is a necessary condition for a high level of capital formation. In Keynesian analysis, however, capital accumulation is treated as irrelevant and saving as positively harmful.(7) A major conclusion of Keynesian theory is that unemployment during the Great Depression was caused by a low level of spending – reflecting the desire of households to save more than firms wished to invest. The importance of maintaining a high level of aggregate demand in Keynasian theory provided justification for a wide variety of public policies designed to encourage spending and to discourage saving.(71) What has been the result? "Unfortunately, our policies have been very successful in depressing the rate of saving....And since the amount of saving that any nation does effectively limits the amount of investment that it can make, these low saving rates have caused correspondingly low rates of investment."(72)

The theory of entrepreneurship further demonstrates why the Keynesian animus towards saving is misdirected. The accumulation of capital hinges on savings that provide the resources necessary for investment. Yet saving is not sufficient, since there must be intertemporal plan coordination for savings to be converted into the most highly valued investments. Prices, profits, and interest rates all play key roles in decisions concerning production over time.

Capital formation is also affected by redistribution and "rent-seeking" activities. Rent seeking is the term applied to efforts by individuals and groups to achieve income transfers through the aegis of the state.(73) Special interest groups in some cases seek to increase their incomes by lobbying directly for income transfers. The increase in rent-seeking activities and the resulting income transfers have reduced the profitability of entrepreneurial activity because of increased tax burdens. In other cases, organized groups seek legislation to raise some price or wage. Gains to particular groups from government-sanctioned and enforced cartels in agriculture, labor, and other markets have been achieved by restricting output to obtain higher prices. Regardless of the particular form of government-

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enforced restriction on competition, the effect is to increase income to small groups at the expense of overall productivity and output making the economy less dynamic.(74)

Incentives, information, and coordination are all important aspects of entrepreneurial activity and of capital formation. This suggests that taxation directly affecting savings and capital formation cannot be considered independently of government intervention in general.(75) Stated differently, the coordination of economic activity (including capital formation) is affected not only by tax policies but also by numerous other market distortions, including those rooted in monetary and regulatory policies. The effects of monetary policies on inflation, interest rates, and investment, although highly important, are beyond the purview of this paper.

Capital formation hinges on the extent to which key market signals – prices, profits, and interest rates – are free to perform their coordination roles in the market process. Consequently, the removal of tax disincentives alone may not be sufficient to significantly increase capital formation when prices, profits, and interest rates are distorted by such factors as price controls, inflation, and economic regulations. However, tax disincentives can be sufficiently great so as to impede entrepreneurial activity significantly even in an otherwise unhampered market. Moreover, tax disincentives are always a deterrent to entrepreneurship, whether or not there are other distortions.

Implications and Conclusions

Although antitrust policies are ostensibly designed to foster competition, numerous governmental agencies and activities deliberately restrict competition. These activities hamper or prohibit the operation of decentralized markets thereby impeding the discovery process of the market. The competitive entrepreneurial market process approach, focusing on how firms act, stresses the importance of rivalrous competition that "requires not large numbers of buyers and sellers but simply *freedom of entry*."(76) There is a great deal of casual evidence that unhampered markets are inherently competitive and that, in practice, effectived restrictions on competition are almost always rooted in the power of the state.(77)

Since the market is a competitive discovery process, government intervention to tax away windfall profits or to initiate

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"antitrust policies" is unlikely to foster increased competition. In reality, government attacks on "monopoly power" are often attacks on firm advantages achieved through alert entrepreneurship. Moreover, effective restrictions on competition and taxation are similar in that both are rooted in state power. This raises the question: How can the harmful effects of state-supported monopoly power and taxation be reduced? Or, alternatively: What can be done to increase capital formation and productivity? The conclusion of Hayek concerning the dangers of economic planning appears to be fully applicable to government policies affecting entrepreneurship and capital formation. "If man is not to do more harm than good in his efforts to improve the social order, he will have to learn that...he cannot acquire the full knowledge which would make mastery of the event possible. He will therefore have to use what knowledge he can achieve, not to shape the results as the craftsman shapes his handiwork, but rather to cultivate a growth by providing the appropriate environment, in the manner in which the gardener does this for his plants."(78)

The effect of taxation and other market impediments on capital formation clearly is related to the size and scope of government. Policies that reduce taxation, government regulations, and "rent seeking" by special interest groups also will increase entrepreneurial incentives, improve economic coordination, and thereby promote capital formation and productivity. Possible modifications of the political process to reduce the scope and magnitude of rent-seeking behavior is addressed in other papers of this study. Regardless of the merits of particular alternative institutional reforms, Mitchel's conclusion appears appropos: "While collective choice stands in the sharpest contrast to the market, marginal improvements are possible. But of all improvements the most effective is a steady diminution of the scope of government."(79)

In the final analysis, all taxes adversely affect entrepreneurial activity – the key element in capital formation. The level of taxation is closely related to the scope of government. Consequently, a decrease in taxes implies a diminution in the scope of government. This implies that an increased understanding of the entrepreneurial market process is an important step in achieving the political and economic environment necessary for investment and capital formation.

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in achieving the political and economic environment necessary for investment and capital formation.

Although an "economic education revolution" is a necessary precondition in limiting the role of government, economic theory does not provide an objective procedure for determining the level of taxation or other public policies. Since costs and benefits are inherently subjective and cannot be aggregated across individuals to determine social costs and benefits, public policies cannot be determined on strictly economic grounds.(80) Consequently, economic theory is not a substitute for political and ethical analysis in resolving policy problems.(81) If freedom is accepted as an ethical standard, individuals have the *right* to engage in voluntary mutually beneficial exchange. Free enterprise or economic freedom means the right of anybody to compete — not the right of existing firms to maintain their markets. Income transfers obtained through state-imposed restrictions on competition are not consistent with economic freedom. In this light, state-sanctioned and enforced restrictions on competition are inherently coercive and, thus, ethical issues.

A recognition of the importance of entrepreneurship in the market process shifts the focus away from the conventional economic approach emphasizing maximization techniques, equilibrium conditions, and perfect competition. In the entrepreneurial market process approach, much less emphasis in economic analysis is placed on determining the optimal allocation of resources, the most profitable pattern of production, or the proper distribution of income. In considering monopoly, taxation, entrepreneurship, and other economic issues, the focus of attention rather is on the framework of institutions and rules within which people can effectively cooperate in pursuing their own diverse ends.(82) The payoff from additional work on this "morally relevant" approach to political economy is potentially great.(83)

FOOTNOTES

(1) Ludwig von Mises, *Human Action,* Third ed. (Chicago: Henry Regnery Company, 1966), pp. 809-810.

(2) This paper contrasts two theories of competition. The "structuralist" approach emphasizes the importance of "perfect competition." The "behaviourist" approach, in contrast, is concerned with how firms *act.* Donald Armstrong, *Competition versus Monopoly* (Vancouver: The Fraser Institute, 1982). In this chapter,

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these approaches are generally referred to as the conventional neoclassical approach and the entrepreneurial market process (or profit and loss) approach, respectively.

(3) Milton Friedman, *Price Theory* (Chicago: Aldine Publishing Co., 1976), p. 126. Gary S. Becker, *Economic Theory* (New York: Alfred A. Knopf, 1971), p. 94.

(4) Glahe, Fred R. and Dwight R. Lee, *Microeconomics: Theory and Applications* (New York: Harcourt, Brace, Jovanovich, Inc., 1981), p. 287.

(5) Jack Hirshleifer, *Price Theory and Applications,* 2nd ed. (Englewood Cliffs, New Jersey: Prentice Hall, 1980), p. 232.

(6) Harold Demsetz, "Why Regulate Utilities?" *Journal of Law and Economics* 11 (April 1968): 55-65.

(7) Jan Bellamy, "2 Utilities Are Better Than One," *Reason* 13 (October 1981): 23-30.

(8) E.S. Savas, *Privatizing the Public Sector* (Chatham, New Jersey: Chatham House Publishers, Inc., 1982).

(9) Israel M. Kirzner, *Competition and Entrepreneurship* (Chicago: University of Chicago Press, 1973), p. 99.

(10) Edwin Mansfield, *Microeconomics: Theory and Applications* (New York: W.W. Norton and Company, 1979, p. 281.

(11) Dominick Armentano, *Antitrust and Monopoly: Anatomy of a Policy Failure* (New York: John Wiley and Sons, Inc., 1982), p. 105.

(12) E.C. Pasour, Jr., "Monopoly Theory and Practice – Some Subjectivist Implications: Comment on O'Driscoll," in *Method, Process and Austrian Economics: Essays in Honor of Ludwig von Mises,* ed. I.M. Kirzner (Lexington, Massachusetts: D.C. Health and Company, 1982).

(13) Richard H. Leftwich and R.D. Eckert, *The Price System and Resource Allocation* (Chicago: The Dryden Press, 1982), p. 331.

(14) Gerald P. O'Driscoll, Jr., "Monopoly in Theory and Practice," in *Method, Process and Austrian Economics,* p. 200.

(15) Richard H. Leftwich and R.D. Eckert, *The Price System and Resource Allocation,* p. 342.

(16) Ludwig von Mises, *Planning for Freedom,* Memorial ed. (South Holland, Illinois: Libertarian Press, 1974).

(17) Gerald P. O'Driscoll, Jr., "Monopoly in Theory and Practice," p. 189.

(18) Even if market competition between firms is restricted by government, there is still likely to be competition by firms in the political arena. The theory of "rent seeking" suggests that individuals and firms compete in attempts to use the power of the state to enhance their own economic interests. James D. Buchanan, R.D. Tollison, and Gordon Tullock, *Toward a Theory of the Rent-Seeking Society* (College Station: Texas A & M University Press, 1980).

(19) Benjamin A. Rogge, *Can Capitalism Survive?* (Indianapolis: Liberty Press, 1979), p. 147.

(20) Israel M. Kirzner, *Competition and Entrepreneurship.*

(21) As von Mises stresses, it should be recognized that: "there is nothing 'normal' in profits and there can never be an 'equilibrium' with regard to them. Profit and loss are, on the contrary, always a phenomenon of a deviation from 'normalcy,' of changes unforeseen by the majority..." Ludwig von Mises, *Human Action,* p. 297.

(22) "In the short run...there are often supranormal...rates of profit for some firms even with free entry....What gives rise to these temporary profits? Most notably, innovations of one kind or another – discoveries of new technologies, previously unsatisfied demands of consumers, low cost methods of production, and so on. And the greater the extent of the profits due to difficulties of entry and imitation, the greater the reward to the innovations that mainly explain economic growth and progress!" Mancur Olson, *The Rise and Decline of Nations* (New Haven: Yale University Press, 1982), p. 61.

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(23) S.C. Littlechild, "Misleading Calculations of the Social Costs of Monopoly Powers," *The Economic Journal* 91 (June 1981): 348-363.

(24) Ludwig von Mises, *Planning for Freedom,* p. 19.

(25) Benjamin A. Rogge, *Can Capitalism Survive?* pp. 143-144.

(26) S.C. Littlechild, "Misleading Calculations of the Social Costs of Monopoly Power," p. 258. Dean A. Worcester, Jr., "On the Validity of Marginal Analysis for Policy Making," *Eastern Economic Journal* 8 (April 1982): 87.

(27) "The charge...that capitalism is doomed by the growth of monopolies is unfounded. Few monopolies would survive if it were not for protective government policies. The tremendous progress in transportation and communication technology, the rapid spread of technological knowledge, the development of new industrial centres in different parts of the world...and the resulting rapid growth of world trade in manufactured goods have undermined monopoly positions." Gottfried Haberlier, "Schumpeter's Capitalism, Socialism and Democracy after Forty Years," in *Schumpeter's Vision,* ed. A. Heertje (New York: Praeger, 1981), p. 83.

(28) "It may be said quite categorically that at the present time there is no established economic theory of the entrepreneur." Mark Casson, *The Entrepreneur: An Economic Theory* (Totowa, New Jersey: Barnes and Noble, 1982), p. 9.

(29) W.J. Baumol, "Entrepreneurship in Economic Theory," *American Economic Review* 58 (May 1968): 69.

(30) Israel M. Kirzner, *Perception, Opportunity, and Profit* (Chicago: University of Chicago Press, 1979).

(31) F.A. Hayek, *Individualism and Economic Order* (Chicago: University of Chicago Press, 1948), p. 41.

(32) T.W. Schultz, "The Value of the Ability to Deal with Disequilibrium," *The Journal of Economic Literature* 13 (September 1975): 829.

(33) "Conventional economics is not about choice, but rather about acting according to necessity." G.L.S. Shackle, *Decision, Order and Time in Human Affairs* 2nd ed. (London: Cambridge University Press, 1969), p. 272. Buchanan explains why this is so: "Once the format has been established in allocation terms, some solution is more or less automatically suggested. Our whole study becomes one of applied maximization of a relatively simple computational sort." James M. Buchanan, *What Should Economists Do?* (Indianapolis: Liberty Press, 1979), p. 24.

(34) Loasby indicates why choice is rooted in uncertainty. "If choice is real, the future cannot be certain; if the future is certain, there can be no choice." Brian J. Loasby, *Choice, Complexity and Ignorance* (New York: Cambridge University Press, 1976), p. 5.

(35) I.M. Kirzner, *Perception, Opportunity, and Profit.*

(36) T.W. Schultz, "Investment in Entrepreneurial Ability," *Scandinavian Journal of Economics* 82 (4, 1980): 437-448.

(37) Israel M. Kirzner, *Competition and Entrepreneurship.*

(38) Brian J. Loasby, "The Entrepreneur in Economic Theory," *Scottish Journal of Political Economy* 29 (November 1982): 241.

(39) "Suppose that a...firm in any purely competitive industry discovers a new method of production that is significantly less expensive than any previously known, but suppose also that increasing costs...ensure that the innovator will not take over the industry. The innovative firm has no monopoly power...but until others can successfully initiate the innovation it has supranormal profits. So it is disequilibrium rather than monopoly itself that is emphasized here as the reward to innovation." Mancur Olson, *The Rise and Decline of Nations,* p. 61.

(40) F.A. Hayek, *Individualism and Economic Order.*

(41) F.A. Hayek, *New Studies in Philosophy, Politics, Economics and the History of Ideas* (Chicago: University of Chicago Press, 1978).

(42) Jack Hirshleifer, *Price Theory and Applications.*

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(43) Harold Demsetz, "Information and Efficiency: Another Viewpoint," *Journal of Law and Economics* 12 (April 1969): 1-22.

(44) "But the critical question is, not what should the pattern of resource allocation look like, but how is it to be achieved and the perfectly competitive model ...provides no recipe for achieving anything." Brian J. Loasby, *Choice, Complexity and Ignorance,* p. 190.

(45) "Ignorance is like subzero weather: by a sufficient expenditure its effects upon people can be kept within tolerable or even comfortable bounds, but it would be wholly uneconomic entirely to eliminate all its effects." George J. Stigler, "The Economics of Information," *Journal of Political Economy* 69 (June 1961): 224.

(46) James M. Buchanan, *Cost and Choice* (Chicago: Markham Pub. Co., 1969).

(47) James M. Buchanan, *What Should Economists Do?,* p. 63.

(48) E.C. Pasour, Jr., "Economic Efficiency and Inefficient Economics: Another View," *Journal of Post Keynesian Economics* 4 (Spring 1982): 454-459.

(49) Israel M. Kirzner, *Perception, Opportunity and Profit,* p. 120.

(50) "At each instant, because the market is in a state of disequilibrium, genuine allocative inefficiencies remain to be removed simply because entrepreneurs have not yet noticed the profit opportunities these inefficiencies represent." Israel M. Kirzner, *Perception, Opportunity, and Profit,* p. 135.

(51) "A longer run view of what may seem to be excessive profits or losses is appropriate because every successful penetration of the unknown successful because of artful foresight, scientific estimation, or plain luck gives the entrepreneur an edge ...that can be classified as a monopoly return." Dean A. Worcester, Jr., "On the Validity of Marginal Analysis for Policy Making," p. 87.

(52) Ludwig von Mises, *Planning for Freedom,* p. 123.

(53) What are the reasons for this neglect? Worcester suggests three reasons. "Perhaps most important is that there is virtually no theory of entrepreneurial activity...Secondly, each generation seems to expect the stationary state to emerge... Should this happen, entrepreneurs would have little or nothing to do...Finally, there is the matter of self-interest....if the 'centralized computation way of finding efficient patterns' is, in principle, equivalent to the 'decentralized, atomistic way' professional advantage combines easily with social usefulness if some way can be found to reduce the costs of the centralized procedure below the costs of decentralized procedures." Dean A. Worcester, Jr., "On the Validity of Marginal Analysis for Policy Making," p. 86.

(54) Ibid.

(55) Joseph A. Schumpeter, *Capitalism, Socialism, and Democracy,* Third ed. (New York: Harper and Brothers, 1947), p. 90.

(56) Paul Heyne, *The Economic Way of Thinking,* 4th ed. (Chicago: Science Research Associates, Inc., 1983), p. 199.

(57) Ibid.

(58) "*Economic rent* is defined as that portion of the payment to the supplier of an input that is in excess of the minimum amoung necessary to retain the input in its present use." Edgar K. Browing and J.M. Browning, *Microeconomic Theory and Applications* (Boston: Little, Brown and Co., 1983), p. 434. In order for the return to entrepreneurial activity to be an "economic rent," the supply of entrepreneurship must be perfectly inelastic so that quantity available does not respond to changes in the expected return.

(59) Ludwig von Mises, *Human Action,* pp. 292-293.

(60) Murray N. Rothbard, *Power and Market: Government and the Economy* (Menlo Park, California: Institute for Humane Studies, 1970), p. 65.

(61) The Economic Recovery Tax Act (ERTA) of 1981 reduced the highest nominal marginal tax rate from 70 percent to 50 percent.

(62) "In the decade of the 1970s...the real tax rate on investment income...was

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not 70 percent, but 7p0 percent of a nominal amount of earnings that was most inflation, combined with a decline in the value of principal equal to the rate of inflation...On a $10,000 certificate of deposit earning 10 percent interest, for example, pretax earnings would be $1,000, taxation would be $700, exclusive of state levies, and the loss in principal due to an inflation rate of 7 percent would be $700. The real tax, therefore, would be $1,400 on earnings of $1,000, or 140 percent...." George Gilder, *Wealth and Poverty* (New York: Basic Books, Inc., 1981), p. 175.

(63) Thomas Humbert, *Tax Indexing: At Last a Break for the Little Guy* (Washington, D.C.: The Heritage Foundation, 1983), p. 1. ERTA provides that all tax rate brackets and personal exemptions are to be indexed for inflation beginning in 1985. There was, however, a political attempt in 1983 to repeal tax indexing before it became effective. The future of tax indexing remains uncertain as of March 1984.

(64) Joseph A. Pechman, "Anatomy of the U.S. Individual Income Tax," in *Comparative Tax Studies: Essays in Honor of Richard Goode,* ed. S. Cnossen (New York: North-Holland Publishing Co., 1983), p. 81.

(65) A number of policies that have discouraged saving are identified in the following section.

(66) Ludwig von Mises, *Planning for Freedom,* p. 152.

(67) Lachman has stressed that the concept "capital" as used by economists has no clear and unambiguous meaning and the inherent problem of measuring capital. Sometimes the term capital is used to denote material resources, sometimes their money value. The basic problem is that since capital resources are heterogeneous both physically and in use, the "best" use of capital is not *given* but is instead an entrepreneurial decision. In the words of Lachman: "The generic concept of capital without which economists cannot do their work has no measurable counterpart among material objects; it reflects the entrepreneurial appraisal of such objects. Beer barrels and blast furnaces, harbour installations and hotel room furniture are capital not by virtue of their physical properties but by virtue of their economic functions. Something is capital because the market, the consensus of entrepreneurial minds, regards it as capable of yielding an income." Ludwig M. Lachman, *Capital and Its Structure* (Kansas City: Sheed Andrews and McMeel, Inc., 1978), P.X.V.

(68) "Profit hoped for, profit deemed possible, drives the market...*Investment* in long-lasting and complex equipment is also in essence an operation decided on under market influences, under the hope of profit." G.L.S. Shackle, "Means and Meaning in Economic Theory," *Scottish Journal of Political Economy* 29 (November 1982): 233.

(69) F.A. Hayek, *New Studies in Philosophy, Politics, Economies and the History of Ideas.*

(70) Martin Feldstein, "The Retreat from Keynesian Economics," *The Public Interest* (Summer 1981): 97.

(71) "...our low saving rate does not reflect any single policy but rather a whole range of policies that affects every aspect of economic life: tax rules that penalize saving; a social security program that makes saving virtually unnecessary for the majority of the population; credit market rules that encourage large mortgages and extensive consumer credit while limiting the rate of return available to the small saver; and perennial government deficits that absorb private saving and thereby shrink the resources available for investment." Martin Feldstein, "The Retreat from Keynesian Economics," p. 101.

(72) Ibid., p. 99.

(73) James M. Buchanan, R.D. Tollison and Gordon Tullock, eds., *Toward a Theory of the Rent-Seeking Society.*

(74) "The growth of coalitions with an incentive to try to capture a larger share of the national income...and the increased bargaining...that cartels create alter the pattern of incentives and the direction of evolution in a society. The incentive to

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produce is diminished; the incentive to seek a larger share of what is produced increases." Mancur Olson, *The Rise and Decline of Nations,* p. 72.

(75) "...even if supply-side tax policies are instituted and the level of savings and investment increases dramatically, the informational problems associated with distorted prices and interest rates that guide the channeling of this investment remain... tax cuts do not address the problem of determining which specific capital goods should be bought, where should new plant and equipment be located, how capital-intensive should any given production process be and how do these investment plans dovetail with the plans of other producers and with consumers. These problems can be solved only by removing the distorting influences on prices and other market signals." Richard H. Fink, *Supply-Side Economics: A Critical Appraisal* (Frederick, Maryland: University Publications of America, Inc., 1982), p. 392.

(76) Israel M. Kirzner, *The Perils of Regulations: A Market Process Approach* (Coral Gables, Florida: Law and Economics Center, 1978), p. 9.

(77) Benjamin A. Rogge, *Can Capitalism Survive?,* p. 47.

(78) F.A. Hayek, *New Studies in Philosophy, Politics, Economics and the History of Ideas,* p. 34.

(79) William C. Mitchell, "Efficiency, Responsibility, and Democratic Politics," in *Liberal Democracy,* eds. R. Pennock and J.W. Chapman (New York: New York University Press, 1983), pp. 367-368.

(80) Although economic analyses often purport to measure "social costs" and "social benefits," the subjective nature of cost and value means that "...net social benefit is an artificial concept of direct interest only to economists." S.S. Littlechild. "The Problem of Social Cost," in *New Directions in Austrian Economics,* ed. Louis M. Spadaro (Kansas City: Sheed Andrews and McMeel, Inc. 1978), p. 92. Although economic theory provides knowledge useful to policy choices, it is not sufficient to enable the economist to advocate any public policy, since policy decisions ultimately rest on ethical or value judgments. Murray N. Rothbard, *The Ethics of Liberty* (Atlantic Highlands, New Jersey: Humanities Press, 1982), p. 212.

(81) G. Warren Nutter. *Political Economy and Freedom* (Indianapolis: Liberty Press, 1983).

(82) Leland B. Yeager, "Economics and Principles," *Southern Economic Journal* 42 (April 1976): 559-571.

(83) James M. Buchanan, "The Related but Distinct 'Sciences' of Economics and of Political Economy," *British Journal of Social Psychology* 21 (1982): 175-183.

This theme covered in this article will be more fully developed by the author in a volume dealing with the subject of taxation to be published by the Pacific Institute for Public Policy Research, under the editorship of Dwight Lee.

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COMPARABLE WORTH: THE NEW FEMINIST DEMAND

By Bruce Powell Majors

The Political Economy of Comparable Worth

"Comparable worth" is the new feminist proposal to use legislation, regulation, and court decision to achieve equal incomes between men and women, by legally mandating that "male dominated" and "female dominated" occupations judged to be equivalent, along various allegedly measurable dimensions, be paid equally. The concept was first put forward by a group of Hillsboro, Oregon, prison matrons in a suit against the county penal system. Their case traveled to the Supreme Court, where Justice William Brennan awarded the matrons back pay, but did not cite "comparable worth" as the basis for doing so.(1) Within the same month, June of 1981, the city of San Jose, California, implemented "comparable worth" evaluations and wage raises legislatively, for municipal workers, at a cost of $5 million annually. The concept was also cited in a $52 million dollar sex discrimination case against a major airline, and in the award of $1 billion dollars in back pay and wage raises to Washington state workers the U.S. District Judge Jack Tanner's decision in *AFSCME v. State of Washington* (82-465).(2) Eighty-five state and local governments are considering comparable worth proposals of some kind,(3) but the "real target," according to Cornell economist George Hildebrand, is "federal intervention into the occupational wage and salary structure on a very large, and possibly even massive scale."(4) Any such shift will involve a transfer of power concerning wage bargaining from millions of employers and employees who know in detail the particular jobs involved, to a small number of bureaucrats who do not have this information.

The "need" for comparable worth regulation is based on the following statistics. In 1939, the median income of women who worked year-round was 58 percent of the median income of men. In 1981, despite passage of the Equal Pay Act and other anti-discrimination laws, women earned 59 percent of the median income of men.(5) But does this mean that the Equal

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Pay Act and other anti-discrimination laws have failed (assuming that they were ever needed)? Consider the following evidence:

> According to one federal study, women in their thirties who have worked continuously since high school earned slightly more than men in their thirties who had worked continously since high school. (6)
>
> Unmarried female academics earn slightly more than do unmarried male academics. (7)
>
> Unmarried female academics become full professors faster than unmarried male academics. (8)

In short, there is a good deal of evidence that single women and single men with similar work experience do earn equal pay (in fact, as we will see in the next section, sophisticated proponents of comparable worth do not dispute this).

Nevertheless, considered as economic aggregates, working women and working men do not receive equal pay. Why? Because the jobs that women go into do not pay as much as the jobs men go into. And why is that? The feminist answer, given to us by *Washington Post* columnist Judy Mann, is that "jobs requiring strength and endurance were given more value than jobs requiring tact or patience." (9)

Clearly, this answer is wrong. Computer programming and engineering, two relatively male-dominated fields which pay quite well, require patience. But the fundamental – and revealing – error in the feminist thinking is the belief that "value" is "given" by a central person or group – that the price of services like cleaning or computer programming is set conclusively, and that "we" can change it, without any ill consequences.

Nobel laureate Friedrich Hayek exposed this error in his classic essay, "The Use of Knowledge in Society":

> What is the problem we wish to solve when we try to construct a rational economic order? On certain familiar assumptions the answer is simple enough. *If* we possess all relevant information, *if* we can start from a given system of preferences, and *if* we command complete knowledge of available means, the problem which remains is purely one of logic. That is, the answer to the question of what is the best use of available means is implicit in our assumptions....
>
> This, however, is emphatically *not* the economic prob-

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> lem which society faces. And the economic calculus which we developed to solve the logical problem does not provide an answer to it. The reason for this is that the "data" from which the economic calculus starts are never for the whole society "given" to a single mind which could work out the implications and can never be so given.(10)

Supporters of comparable worth believe that the economic problem consists of nothing more than achieving their "system of preferences," preferences which may for now be taken to be merely equality in men's and women's incomes (but which are actually something more than just this, to be considered in the next section). By overlooking the more fundamental problem – that of collecting the "data," the information about supply and demand for goods and services, which is scattered throughout the economy in isolated bits – they would wreak havoc with the economy, and at the same time wipe out many of the gains of the feminist movement. The main victims of comparable worth may well thus be women, who would be affected at least three ways.

First, comparable worth will do for women (and a few men) who enter the labor market through traditionally feminine jobs what minimum wage laws have done for minority teenagers: it will price them out of the labor market. To rephrase this in a way that discloses Hayek's "Austrian" or "information economics" insight: potential workers seeking employment that is less demanding than the average will not be able to *signal* this to potential employers by offering their services at a commensurately reduced wage. A 1981 report of the National Research Council noted that comparable worth would result in "reducing employment either because employers shift to alternative, less labor-intensive methods of production or (if the new labor costs were paid and passed on) because consumers might switch to other, less expensive goods and services."(11) Many working women will think that they are being "liberated" by feminist social engineering, only to find that they are losing their jobs to machines, as teachers and librarians are replaced or supplemented by computer terminals, nurses by monitoring equipment, and waiters and waitresses (and restaurants) by fast-food enterprises.

Second, if women have nothing to lose by staying in jobs requiring skills that many workers have (and hence jobs which

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consumers do not have to reward highly), they will have no incentive to move into traditionally male-dominated fields – and no information, in the form of wage discrepancies, about which fields are most in demand. Comparable worth in effect tells the woman entering the labor force not to worry her pretty little head about a challenging career. From the feminist viewpoint, comparable worth would thus be self-defeating.

Third, the studies cited earlier reveal that for most couples marriage advances the husband's career and inhibits that of the wife; single men and women in the same field and of the same age have more nearly equal incomes. Most husbands and children make demands on their wifes' and mothers' time and energy that prohibit most women from committing themselves to their careers as fully as do male workers in the same field. Were comparable worth regulations to be enforced, they would act as a subsidy to this traditional marriage, if not by simply causing female unemployment, then by abolishing the wife's incentive to demand more domestic equality – the higher wages earned by tired, distracted and uncommitted women workers would falsely inform them that they were successfully combining marriage and career, even if their husbands and families had not reduced their demands, or the women themselves had not acquired the ability to manage the dual burdens without being less productive on the job. Again, from the feminist point of view, comparable worth would be self-defeating.

On this point, there is some evidence that comparable worth regulations and other feminist social engineering just cannot be imposed on an entire economy over any significant length of time. Hedrich Smith returned from the USSR, a country that combines near-complete control of the economy with an at least nominal commitment to sexual equality, with the following report:

> In Russia, equal pay for equal work is an adopted principle, but getting the equal work is the problem. Millions of women are shunted into the lower-paying, less prestigious fields. Teaching and medicine are prime examples. These are practically at the bottom of the pay and status scales and these are the professions in which women are the most heavily represented. In industry, women work mostly in the light, consumer section where, according to Soviet studies, pay and all other benefits are

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> well below those in heavy industry (where men predominate). In farming, women provide the core of the low-paid, unskilled field hands while men operate the machinery and get better pay. Perhaps most indicative of the situation nationwide, one major Soviet economic study drafting a working-class family budget assumed that the husband would earn 50 percent more than the wife.(12)

Such considerations have led some feminists to question whether the problems that concern them can indeed be solved by governmental social engineering. Feminist poet Adrienne Rich, herself a socialist, asked in a recent book, "How much does this really have to do with capitalism, and how much with the system which...predated capitalism and survived under socialism?"(13) Stripped of the jargon, Rich is coming dangerously close to posing the heretical question of whether feminist values are not best attained by private and voluntary means (and suggesting the even more heretical question of whether men's and women's different natures are not significant for their different successes in the economic – and other – realms of life). But Adrienne Rich lives near Cambridge, Massachusetts, where political power is sometimes merely an object of contemplation. In Washington, D.C., where power is everyone's bread and butter, the *Washington Post*'s Judy Mann is busy informing us that "labor unions, the Democratic Party and women's organizations are now supporting comparable worth standards."(14)

It is tempting to conclude that labor unions have come out for comparable worth for the same reasons that they have supported much of the labor legislation of the past. Labor unions in Britain during the industrial revolution and in the United States during the Progressive era supported protective labor legislation and the "family wage" system in order to drive female competition out of the labor market. Labor unions today support minimum-wage laws, restrictions on immigration, tariffs and trade quotas as a means to protect themselves from inexpensive labor offered by less-skilled workers both foreign and citizen. It could be persuasively suggested that unions now support the comparable worth campaign as a public relations gimmick by which to unionize the women who have newly entered the labor force, as replacements for those workers who are steadily leaving the unions. The most likely reason for union

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involvement in the comparable worth drive is, however, the fact that comparable worth entails formal, bureaucratic determination of wage rates. In such a determination, employer and employee will both send representatives to a meeting where they will articulate their demands and the reasons for them. The role of union representation will be institutionalized.

Because of the uncertainties about the profitability of investing in a new ERA campaign, the National Organization for Women and other feminist organizations realize that they must have a program to put forward if they are to attract new members and contributors – or, in other words, if they are to continue to exist. They, along with the Democratic Party, have hit upon comparable worth as part of a wider political realignment, which reverses earlier feminist goals by grounding itself in the differences between men's and women's political values. A discussion of this leads us out of a consideration of the economics of comparable worth, and into the wider arena of its place in modern political philosophy.

II. The Political Philosophy of Comparable Worth

In order to consider the relation of "comparable worth" to modern political philosophy, one must first consider what "comparable worth" is not. Comparable worth is not 1) aptly named, for it is not merely about comparable, but *commensurate* worth, value or work, 2) egalitarian, despite such phrases as "equal pay for work of comparable value," or 3) ultimately an issue about the political relations between men and women.

1) "Comparable" means "able to be compared." Before the advent of "comparable worth," one could compare the worth of any two jobs, either the market determination (a collective and subjective determination) of their "worth," i.e. the prices of goods produced and the wages received, or their objective worth in moral terms, or their individual and subjective "worth" in terms of personal tastes. One could make such comparisons as "better paid," "more noble," or "more exciting. "Such comparisons, if mathematicized, would not (except in the case of prices and wages) be expressed in cardinal but in ordinal numbers (e.g. 1st, 2nd and 3rd most noble professions), and would thus not have reference to a common measure (e.g. some unit x of which they are multiples and sums: worth 1x, worth 2x, worth 3x). The proponents of comparable worth are

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actually proposing "commensurable worth." They are proposing that the market "worth be replaced by a mathematicized version of moral worth, which will have a "common measure or standard." "Worth," or rather wages, will no longer be the product of the coordination and integration of the various tastes, and opinions and knowledge about what is worthwhile, of all the participants in the market. Instead worth or wages will be a function of how many "points" a job is given in comparable worth evaluations. Such "points" – given for such things as responsibilities, education, expenditure of energy, disagreeability of work conditons, all quantified – and their commensurability and assigned monetary values may not be objective in the sense of being discoverable in the nature of the job. But they will be subject to mathematical manipulation, as cardinal numbers and commensurable units. They will in fact be a reformulation of Marx's concept of labor time, where the true value of a good or service depends upon the *amount* of labor spent producing it.(15) Just as Marx proposed that "skilled labour counts...multiplied simple labour...a definite quantity of the latter labour alone,"(16) so the comparable worthers propose that all jobs ought to have politically defined, mathematically related, measurable, cardinal values.

Marx eventually had to fatally qualify this concept of economic value by defining economic value as socially-necessary labor time.(17) After all, eight hours of hard labor digging and refilling a ditch would usually has no economic value. So, the eight hours must be "socially necessary," i.e. demanded by market prices or state edicts. In a similar lacuna, comparable worthers have yet to say why a woman with a doctorate in art history or a master's degree in women's studies should receive "points" in her job as a secretary for each quantity (year) of education, and hence be paid more than male sanitation workers who are high school drop-outs. If the market does not judge certain expenditures of labor time (a M.A.) as making the product more valuable, then why should such an expenditure of labor time receive any more monetary remuneration than digging and refilling a ditch?

2) At least one observor of the comparable worth campaign, journalist Michael Kinsley, has observed that far from being an egalitarian proposal, comparable worth would use government to institutionalize inequality by way of enshrining credential-

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ism. Kensley quotes an unamed AFSCME official as having said: "When a person whose job requires a college education makes less than what is basically a common laborer, there's something wrong."(18) San Jose, California's feminist Mayor Janet Gray Hayes, speaking from her position as chief executive of the first comparable worth utopia, is willing to go on record for credentialism: "We have spent years in training, we have M.A.'s and Ph.D.'s, we supervise as many as 25 people, but we earn less than street sweepers and gardeners. It isn't fair that we earn less than laborers."(19)

Indeed, the credentialism of the proposal may mitigate its feminist content. As Richard J. Schonberger and Harry W. Hennessey Jr., two management analysts, concluded in their study of comparable worth: "The smaller numbers of educated women, some of whom are pressing for a comparable work policy, may indeed benefit from that policy. But so would many or most educated males. Pay based on job content – across the board in our society – would tend to benefit educated female and male professionals and technicians at the expense of unskilled unionized workers and semiskilled tradesmen...."(20) In fact, the comparable worth evaluation in San Jose did conclude that certain male-dominated job categories merited pay raises. In a blatant example of reverse sexism, only the female-dominated categories were granted increases in wages.(21)

3) Mayor Janet Gray Hayes complains that the pre-comparable worth wage structure was not "fair." In this adoption of fairness as the highest political good, Ms. Hayes is joined by the Ellen Goodmans, the Judy Manns, the Ellie Smeals, the Judy Goldsmiths, the feminists of our public life, and their fellow travelors on the left, who claim that the marketplace is not fair. What is this "fairness?"

It isn't equality, as we have seen. Policy analyst Rachel Flick associates this "fairness" with "niceness," non-competitiveness, non-aggression, nurturance, and risk-aversion.(22) The demand for comparable worth is a demand that employees be paid, i.e. nurtured and supported, regardless of how aggressive they are in being alert to which, or competing for those, jobs which provide goods and services most in demand. Flick points out that this demand for comparable worth (a "fairness" that is not equality) coincides with the emergence of the "second stage" of femi-

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nism, the "difference feminism" of Betty Friedan and Carol Gilligan,(23) who argue not that men and women are and ought to be treated as equals, but that men and women are different and complementary, and that women are better. Hence "female" jobs that provide society with the nurturing services should be paid at least as much as the male-dominated professions.

While I would accept this analysis, two questions about it remain: 1) Why does an acceptance of womanliness only become politically correct for feminism when womanliness is articulated ideologically? Female nature is denied, and its generative aspect is also partially denied and is to be brought fully under technological control; feminine conventions are criticized and discarded. Why is only thematized, ideological womanliness, "difference feminism," acceptable. 2) Is comparable worth a purely feminist concept, in this new conception of feminism, or do both feminism and comparable worth have their origins in some prior intellectual or social current?

To answer these questions, I must collect the various threads of argument. There are five threads:

1) The formulation of the comparable worth proposal occured at a time when feminism decided that femaleness/feminity, though not acceptable in its nature or traditional form, could be accepted in its constructed or ideological form.

2) Comparable worth evaluations, like Marx's concept of labor time, make economic value, and thereby much of human life and society, subject to mathematical manipulation.

3) Comparable worth wage structures would very likely mean higher and more secure incomes for educated professionals.

4) Comparable worth rules are replacements for the market's integration of the information about supply and demand possessed in a decentralized fashion by all the participants in the market, an integration which results in tacit or affective knowledge, e.g. prices which convey information and influence behavior.

5) As noted above in the section on political economy, the more sophisticated proponents of comparable worth admit that at least half the male/female wage differential is due to "women having less seniority, staying in the labor force less consistently, and working in jobs with lower intrinsic value....But the rest

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of the wage gap – 20 cents on the dollar – remains unexplained."(24) Here the market economy is assumed guilty until proven innocent. Comparable worth proponents assume that the rest of the gap is bigotry rather than assuming simply that they are ignorant of the causal factors involved, that they have not yet or cannot articulate or measure such factors as the "average woman's" willingness to leave her job when her husband relocates, and how this diminishes her expected value to her employer. The wages that result in the market should reflect such factors, since the "market stands ready to punish an employer" who indulges his (or her) prejudice, by means of "competitors who watch carefully the value they get from the people they hire,"(25) and who are hence led to bid up women's wages equal to their worth in terms of productivity, as a means to obtaining the services of these bargain-priced productive workers.

To restate the last four of these five points more briefly and revealingly:

a) The only acceptable form of knowledge is that of articulate knowledge, not prices, traditions, or other forms of tacit knowledge;

b) Such knowledge is mathematical in character;

c) The possessors of such knowledge should be honored and paid well;

d) Knowledge falling outside of this realm is denied.

These last four propositions direct our vision toward the first, and allow us to recognize it as a part of a greater whole. The new feminism is an ideology which is an articulation of a preference for security (nurturance) over risk (aggressiveness). The New Class, the intellectuals (broadly defined), who are predominately employed in the feminist microcosm of the non-market, minimal-risk environment of non-profit foundations, government bureacracies, and universities, desires to maintain and expand opportunities and to have it's profession honored above all others. Comparable worth promises electoral and legal battles, and if implemented, constant wage negotiations, which will provide opportunities for the pundits, politicians, lawyers and economists of the New Class. More importantly it will provide them with a drama in which they can live their view of reality: a world in which everything important is a matter of conscious activity, specifically of conscious con-

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struction — a world in which everything from wage negotiations to a woman's choice of what style of femininity to embody (and with how much of an investment), and even relations between the sexes, will be a matter of systematic deliberation.

In the new feminism, and the New Class's appreciation of it, one sees the shadow of modern philosophy. Descartes famous prescription that moderns should "render ourselves as masters and possessors of nature"(26) sounds lordly and masculine — the kind of statement that the new left ideologue would seize upon when dizzily trying to "make connections" between slavery, the exploitation of the environment, nuclear weapons and sex role differences.(27) But in fact this is simply a program to replace all the aggressive aspects of nature with a manufactured nurturance, a program founded on a conception of nature whose meager features (duration, solidity, extent) and malleableness do not tend to admit of such fixed differences as male and female, or of complexities beyond scientific and political apprehension and control.

Footnotes

(1) Stephen Wermiel, "Women May Sue On Pay Bias Claims in Unequal Jobs," High Court Rules, 5 to 4," *Wall Street Journal,* 9 June 1981, p. 4.

(2) David Lauter, "Pay Bias Enters a New Age," *The National Law Journal,* 2 January 1984, pp. 1 and 24.

(3) "Beyond Equal Pay for Equal Work," *Business Week,* 8 July 1983, pp. 169-170.

(4) George H. HIldebrand, "The Market System," p. 102, in *Comparable Worth: Issues and Alternatives,* E. Robert Livernash, ed. (Washington, D.C.: Equal Employment Advisory Council, 1980).

(5) Figures from Dr. Janet Norwood, commissioner of the Bureau of Labor Statistics, reported in Judy Mann, "Work Values," *The Washington Post,* 6 October 1982, p. C1.

(6) "The Economic Role of Women," *Economic Report of the President 1973* (Washington, D.C.: United States Government Printing Office, 1973), p. 105.

(7) Thomas Sowell, *Affirmative Action Reconsidered,* Evaluative Studies #27 (Washington, D.C.: American Enterprise Institute for Public Policy Research, 1975), pp. 23-34.

(8) Helen Astin, "Career Profiles of Women Doctorates," pp. 152-153, in Alice S. Rossi, *Academic Women on the Move* (New York: Russell Sage Foundation, 1973).

(9) Mann, "Work Values."

(10) F.A. Hayek, "The Use of Knowledge in Society," p. 77, in *Individualism an Economic Order* (Chicago: The University of Chicago Press, 1948).

(11) *Women, Work and Wages: Equal Pay for Jobs of Equal Value* (Washington,

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D.C.: National Academy Press, 1981), p. 67.

That comparable worth could cause unemployment among women workers has in fact been recognized by both labor leaders and leftist intellectuals. Sol C. Chaikin, president of the International Ladies Garment Workers Union sums up his view of comparable worth: "I'll be damned if I know a way to get the women more money. The value of their work isn't set by theoretical principles but on the value of the work in the marketplace and in the face of competition from overseas, where garment workers make thirty cents an hour." ("The new pay push for woman," *Business Week,* 17 December 1979, pp. 66 and 69.) Socialist-feminist Barbara Ehrenreich notes that "it is hard to insist on higher pay from employers who are busily disinvesting, fleeing overseas, or replacing human labor with robots and microcomputers." ("After the breadwinner vanishes," *The Nation,* 1983, p. 240.)

(12) Hedrich Smith, *The Russians* (New York: New York Times Book Co., 1976), p. 134.

(13) Adrienne Rich, *Of Woman Born* (New York: Norton, 1976), p. 54.

(14) Mann "Work Values."

(15) As Marx puts it: "Coats and linen, however, are not merely values, but values of definite magnitude, and according to our assumption, the coat is worth twice as much as ten yards of linen. Whence this difference in their values? It is owing to the fact that the linen contains only half as much labor as the coat, and consequently, that in the production of the latter, labour-power must have been expended during twice the time necessary for the production of the former. (*Capital,* vol. 1 (New York: Modern Library, 1906), p. 52).

(16) Ibid., pp. 51-52. That comparable worth has Marxist economic theory as one of its ancestors makes it more than a matter of mere polemics when an opponent like Phyllis Schlafly says: "The bottom line of comparable worth is Federal wage controls, which are unacceptable in a free society," (quoted in Tamar Lewin, "A New Push to Raise Women's Pay," *The New York Times,* 1 January 1984, section 3, p. 1).

(17) Ernest Mandel, *An Introduction to Marxist Economic Theory* (New York: Merit Publishers, 1969), p. 19. Also: Mark Blaug, *Economic Theory in Retrospect* (Homewood, Illinois: Richard D. Irwin, Inc., 1968), p. 274-275.

(18) Michael Kinsley, "Worthier Than Thou," *New Republic,* 27 June 1981, pp. 10-11.

(19) Quoted in: David Johnston, "Will They Lead the Way in San Jose?," *Working Woman,* (November 1981), pp. 162.

(20) Richard J. Schonberger and Harry W. Hennessey Jr., "Is Equal Pay for Comparable Work Fair," (*Personnel Journal*), December 1981, pp. 968.

(21) Johnston, "Will They Lead the Way in San Jose?," p. 165. Swimming pool managers were rated by the comparable worth evaluation as deserving of higher wages than they currently received. Since all the managers were male, no raises were granted.

(22) Rachel Flick, "The New Feminism and the World of Work," *The Public Interest* (Spring 1983), pp. 33-44, and "What Do Women Want?" *Policy Review* (Winter 1984), pp. 80-82. In the "New Feminism," Flick discusses "difference feminism"'s relation to comparable worth as a call for rewarding the nurturing professions. In "What Do Women Want," she concludes that the new feminism, unlike egalitarian feminism, appeals to women's natures, and hence can be used to exploit the "gendergap," i.e. the female aversion to risks, either risky and hence highly paid employment, non-risk-minimizing economies (i.e. capitalism), or aggressive foreign policies, which are perceived to be risky.

(23) Betty Freidan, *The Second State* (New York: Summit Books, Simon and Schuster, 1981); Carol Gilligan, *In A Different Voice* (Cambridge, Mass.: Harvard University Press, 1982). "Difference feminism," which says that male and female

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natures are different and complementary, though female natures are better (e.g., if males are to be involved in child-care, they will leave behind their values of aggression, and not teach those to children; but when women enter the market they will take with them their values of "fairness," in the form of welfare programs and comparable worth laws), is thus just the reform version to which the corresponding revolutionary doctrine is lesbian feminism, which was thematized first. For an ideological articulation of lesbianism including a call for the abolition of males, see Mary Daly, *Gyn/Ecology, the metaethics of radical feminism* (Boston: Beacon Press, 1978). For a discussion of what would happen to a community ruled only by the "courageous" or the "moderate" souls, and not both together, see Plato, *Statesman* 307b-308a.

(24) David Lauter, "Pay Bias Enters a New Age," p. 25.

(25) Donald N. McCloskey, *The Applied Theory of Price* (New York: Macmillan Publishing Co., Inc., 1982), p. 469.

(26) Descartes, *A Discourse on Method,* Part IV.

(27) For example, Susan Griffin, *Woman and Nature: The Roaring Inside Her* (New York: Harper and Row, 1979).

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THE CRISIS OF URBANIZATION IN ASIA: FINDING ALTERNATIVES TO MEGALOPOLITAN GROWTH

By Dennis A. Rondinelli

Nearly all projections of population growth over the next two decades indicate that most East and South Asian countries are likely to experience continued high levels of population expansion, migration from rural to urban areas and concentration of urban dwellers in large metropolitan centers. This combination of trends, as identified in the World Bank's most recent *World Development Report,* is one of the strongest threats to rising standards of living in developing countries during the rest of this century.(1) Despite the decline of population growth rates in Asia over the past 30 years, population growth remains higher than increases in the growth of Gross National Product in most Asian countries. As a result the rapid expansion of large cities, combined with poor urban management, accentuates the mass poverty found in so many Asian cities, most of which lack sufficient work opportunities, housing and utilities for their growing populations.

In 1982, about 2.3 billion people lived in the 15 Asian countries listed in Table 1. By the end of the 1990s, demographers estimate that population in these countries will increase by 743 million. Average annual population growth rates were over 2 percent a year in 11 of these 15 countries between 1970 and 1982 and are likely to remain at or near that level in all but a few of them between 1980 and the year 2000. In most Asian countries, and especially in the poorest ones, the growth rate of the urban population is two to three times that of total population. From 1970 to 1982, urban population grew by more than 5 percent a year in Bangladesh, Nepal and South Korea, and from 3 to 5 percent a year in North Korea, Malaysia, the Philippines, Thailand, Indonesia, Pakistan, India and Burma.

About 93 million people will be added to the population of Asian cities over the next 15 years. More than 40 percent of all Asians are expected to be living in urban places by the year 2000. Much of the population growth will occur in the largest metropolitan areas. The United Nations estimates that the number of "million cities" in Asia will increase from the 40 that

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Table 1

POPULATION GROWTH TRENDS IN SELECTED ASIAN COUNTRIES

Country	Population (in millions) 1982	2000[a/]	Average Annual Population Growth Rate (percent) 1970-82	1980-2000	Percent Population Urban 1960	1982	Average Annual Growth of Urban Population (percent) 1960-70	1970-82	Percent of Urban Population in Largest City 1980	Percent of Urban Population in Cities over 500,000 1980
Bangladesh	93	157	2.6	2.9	5	12	6.2	6.0	30	51
Burma	35	53	2.2	2.4	19	28	3.9	3.9	23	23
China	1008	1196	1.4	1.0	18	21	-	-	6	45
Hong Kong	5	7	2.4	1.4	89	91	2.6	2.4	100	100
India	717	994	2.3	1.9	18	24	3.3	3.9	6	39
Indonesia	153	212	2.3	1.9	15	22	3.6	4.5	34	50
Korea, South	39	51	1.7	1.4	28	61	6.5	5.0	41	77
Korea, North	19	27	2.5	2.1	40	63	5.0	4.2	12	19
Malaysia	15	21	2.5	2.0	25	30	3.5	3.4	27	27
Nepal	15	24	2.6	2.6	3	6	4.2	6.7	27	0
Pakistan	87	140	3.0	2.7	22	29	4.0	4.3	21	51
Philippines	51	73	2.7	2.1	30	38	3.8	3.8	30	34
Singapore	3	3	1.5	1.0	100	100	2.3	1.5	100	100
Sri Lanka	15	21	1.7	1.8	18	24	4.3	2.5	16	16
Thailand	49	68	2.4	1.9	13	17	3.6	4.3	69	69

Source: Compiled from World Bank, World Development Report 1984, Washington: World Bank, 1984. Tables 1, 9, 22.

a/ A regression-based standard projection calculated by the World Bank.

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existed in 1960 to more than 175 at the end of the 1990s. Within a decade and a half, the population of Asian cities with a million or more residents is likely to grow from the 96 million that lived in them in 1960 to about 590 million, nearly a five-fold increase in less than 40 years.(2)

Although the percentage of urban population living in the largest cities of Asian countries seems relatively low, the absolute size of the large cities' populations is substantial. More than 50 percent of the urban population now lives in cities with more than 500,000 residents in half of the 15 Asian countries listed in Table 1. It is estimated that in 1980, Beijing and Shanghai each had more than 10 million residents, Seoul, Calcutta and Bombay had more than 8 million each, and Jakarta, Bangkok, Manila, Karachi, Madras and Delhi each had populations of 5 million or more. The populations of the largest cities in Asian countries are expected to double or triple in size between 1970 and the year 2000. (See Table 2.)

Many Asian metropolises will be among the 30 largest cities in the world by the end of this century. The United Nations predicts that unless drastic changes occur in the pattern of urban concentration in Asia in the near future, Shanghai and Beijing will have populations of more than 20 million each, that Bombay, Calcutta and Jakarta will all reach more than 16 million, and that Seoul, Madras, Manila, Bangkok and Karachi will grow to well beyond 10 million. (See Table 2). These large urban regions – most of them in still quite poor countries – will reach the size and scale of what Gottman has called "megalopolises."(3) The characteristics, nature, dynamics and problems of megalopolitan growth in less developed countries are not yet clearly understood, but it is clear from their growth in richer countries of the world that substantial resources are required to manage them effectively and that they generate serious social, economic and physical problems as well as potential economic advantages.

A significant and problematic trend accompanying the increasing concentration of people in large metropolitan areas in the Third World is the dramatic shift in the incidence of poverty. The World Bank estimates that in 1975 about 80 percent of those households living in absolute poverty were found in rural regions; but by the end of the 1990s, nearly half of the absolute poor are likely to be living in *urban* areas.

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Table 2

POPULATION OF LARGEST CITIES IN SELECTED ASIAN COUNTRIES

Country	Cities	Population of Largest Cities (in 000s) 1970	1980	2000	Percent of Urban Population in Largest City 2000	Percent Population Growth in Largest City 1960-1970	1970-1980
Bangladesh	Dacca	1,289	2,841	9,725	30.3	147.9	120.4
Burma	Rangoon	1,453	2,185	4,747	21.2	48.5	50.0
China	Beijing	6,999	10,736	19,931	9.6	22.9	42.0
	Shanghai	10,000	13,410	22,677			
India	Bombay	5,811	8,343	17,056	9.4	33.1	34.9
	Calcutta	6,911	8,822	16,678			
	Delhi	3,531	5,414	11,683			
	Madras	3,030	5,406	12,882			
Indonesia	Jakarta	4,450	7,263	16,591	21.7	64.3	63.2
Korea, North	Pyongyang	911	1,283	2,240	11.2	43.5	40.8
Korea, South	Seoul	5,322	8,490	14,246	37.7	125.3	59.5
Malaysia	Kuala Lumpur	649	1,106	2,552	27.8	75.4	70.4
Pakistan	Karachi	3,139	5,005	11,774	19.5	56.9	59.4
	Lahore	1,877	2,942	6,707			
Philippines	Manila	3,591	5,664	12,313	27.9	56.9	57.7
Thailand	Bangkok	3,205	4,870	11,936	60.1	49.0	51.9

Source: Compiled from United Nations, Patterns of Urban and Rural Population Growth, Population Study 68, (New York: Department of International Economic and Social Affairs, 1980), Table 48.
Populations for 1980 and 2000 are estimated from 1970 figures.

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The number of households living in destitution in Asian cities is expected to increase from a little more than 12 million in 1975 to nearly 38 million by the end of the 1990s. If the average Asian household size remains at about 6 people, more than 228 million city dwellers will be living in absolute poverty by the year 2000.(4)

The Strengths and Weakness of Asian Metropolises

Many who have analyzed these trends have argued that the growth of large metropolitan areas in Asia has been an economically favorable development providing economies of scale and proximity that have been conducive to industrialization, allowing the cities to absorb large numbers of people in manufacturing jobs, and governments to construct modern infrastructure, health, educational, commercial and other facilities that require large population concentrations in order to operate efficiently. The largest metropolises in Asia now play crucial roles in regional economic development. They are communications and transport hubs for their nations, providing international ports, harbors and air facilities; most have become either national or international financial and banking centers, serving as nodal points in networks of national and international trade. They also serve as centers providing educational, health, and training facilities. The commercial, service and government sectors in major metropolitan areas provide millions of managerial, clerical and professional jobs, and the "informal sector" absorbs millions more low- or non-skilled workers.

It is not even the present size of the largest metropolitan areas that poses the most serious problems for Asian countries; it is the prospect of continued rapid growth over the next two decades and the highly skewed distribution of urban population and productive activities in many countries that is the source of increasing concern. As Table 2 indicates, the largest cities in China, North Korea, South Korea and India are projected to grow by an average of 3 to 5 percent a year over the next 16 years, by 5 to 8 percent in Thailand, the Philippines, Pakistan, Malaysia, Indonesia and Burma, and by 12 percent in Bangladesh.

Often the largest metropolitan areas in Asia are "primate cities," with populations that have grown substantially larger than that of the next three or four largest cities, and in which

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the concentration of modern productive and service facilities has become so great as to create marked disparities in levels of wealth and development between them and other regions within their countries. About 35 percent of the Korean population, for example, lives in Seoul or the immediately surrounding metropolitan area, where nearly half of all factories in the country are concentrated – as well as 65 percent of the bank deposits.(5) Seoul has a substantially higher share of medical personnel, medical facilities, high schools, and colleges and universities than other cities or than its share of national population. This disproportionate concentration of people, productive activities, and social infrastructure in the capital city is also characteristic of the Philippines, Indonesia and Thailand.

Moreover, the rapidity of the growth of large metropolitan centers in still relatively poor societies has created serious social problems with which many Asian governments find it difficult to cope.(6) Most large Asian metropolises cannot provide enough jobs for even their current work force let alone the thousands of additional migrants who flow into the cities each year in search of employment. Most of the migrants who come to them each year are unskilled and uneducated and can only find informal sector occupations that provide, at best, subsidtence incomes.

Rapidly growing urban populations place increasing demands on public facilities and services such as health care, education, transportation, roads, police and fire services, and sanitation and drinking water systems that are already overstrained. Continued migration of the rural poor to large metropolitan areas in Asia results in greater concentration of people in slums and squatter settlements, to which basic services and facilities often cannot be extended. Both richer and poorer Asian countries have seen the adverse effects of rapid metropolitan growth. More than 60 percent of Calcutta's population live in slums and makeshift squatter settlements, where sanitation, waste disposal, health and educational services are scarce or nonexistent. More than half of the population of Colombo lives in congested "shanty gardens" and slum areas with minimal services, as do more than 40 percent of the residents of Bombay and one-third of those living in Delhi, Dacca and Manila.(7) More than one-quarter of Kuala Lumpur's population have incomes below the poverty level. Weak revenue bases or inef-

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ficient revenue collection practices, and the limitations on revenue raising placed on them by central governments, make it impossible for most metropolitan governments in Asia to keep pace with expanding public services needs.

Moreover, most large metropolitan areas have traditional and inadequate physical infrastructure to which *ad hoc* accretions have been made that are incapable of providing the coverage or quality of services needed to accommodate their growing populations. Seoul, Bangkok and Jakarta face serious environmental problems from rapid population growth and high density settlement. Jakarta and Bangkok are having increasing problems providing clean drinking water and coping with the massive traffic snarls that have accompanied concentrated urbanization. All Asian metropolises have serious housing shortages.(8)

Finally, the heavy and continued concentration of people and economic activities in the largest metropolises often drains human, financial and natural resources from already poor rural hinterlands, perpetuating or enhancing regional income differentials, retarding the economic development of those areas and preventing the development and growth of other cities, towns and rural areas generally.

Attempts to control the growth of large metropolitan areas in Asia have been notably unsuccessful. Experiments with reversing the flow of migration in China, resettling the urban poor in frontier areas or rural colonization projects in Indonesia and Malaysia, restricting the entry of migrants to national capitals or limiting their access to urban services in the Philippines and Indonesia, and creating industrial growth poles in rural areas in India and other Asian countries have had marginal, if any, effect on slowing the growth of the largest metropolises.(9)

At the same time, the extensive investments in rural development programs designed to increase agricultural productivity and rural household incomes have been slow to show significant results. The World Bank contends that even if agricultural and rural development programs now underway are successful, they are "unlikely to cause significant reduction in the rapidity of growth in urban population or the problems of large cities over the next two decades," especially in those countries where population pressure on rural land remains strong.(10) In any

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case, agricultural development had traditionally freed large numbers of surplus rural workers from farming to find jobs in towns and cities.

Alternatives to Megalopolitan Growth

Despite the difficulties of doing so, most governments in Asia have expressed a desire in their national development plans to limit the growth of their largest metropolitan centers in the future, or at least to slow their rate and pace of expansion. Far fewer governments have been willing to recognize explicitly, however, that their own development policies and investment strategies have played a major role in creating large primate cities and in reinforcing the current trends of urban concentration. Fewer still have been willing to change those policies in order to alter the pattern of urban development.

In most Asian countries the rapid growth of primate cities was the result of colonial economic policies that were reinforced by post-colonial development plans. The growth of one or a few metropolises to enormous size in other countries was the result of economic growth strategies pursued by many Asian governments during the 1950s and 1960s. Both emphasized the concentration of investment in productive capacity and modern social overhead capital in one or a few metropolitan centers in order to maximize the growth of Gross National Product and obtain the highest possible returns on investment.(11)

Both colonial and post-World War II economic growth theories largely ignored the distributional effects and the spatial implications of investment allocation and emphasized industrial over agricultural and rural, development. These policies modernized some sectors of the metropolitan economy, but often left rural regions underdeveloped and poor. Industrial development in the metropolitan areas created "pull" effects that complemented the "push" effects of rural stagnation in generating higher levels of migration to the primate cities.

In many countries with strong primate cities, few secondary and intermediate-sized cities and towns could grow enough to diversify their economies and attract significant numbers of rural migrants. This increasing concentration of people and economic activities in the largest metropolitan areas simply increased their economies of scale and attractiveness, giving the

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primate cities even greater comparative advantages and economies of scale. These advantages created an even stronger economic rationale for concentrating investments in the largest metropolises rather than in other regions or cities within Asian countries.(12)

The economic rationale of such policies, however, has come under increasing criticism, especially in countries that are still in the process of urbanizing. The arguments for developing alternatives are based on two major contentions.

The Adversities of Overconcentration in Primate Cities

The first is that although the massive concentration of population and economic activities in one or a few large metropolitan areas may stimulate higher levels of economic growth in the short run, it also has a tendency to generate spatial polarization, economic dualism, dramatic economic inequalities and diseconomies of scale. These adversities may undermine the ability to sustain high levels of economic growth. The urban industrialization programs in many Southeast and South Asian countries have been at the expense of more widespread agricultural development on which the majority of their populations still depend – and on which they are likely to continue to depend well into the next century – for their livelihood. The assumption that the benefits of concentrated investment in one or two large metropolises would trickle down and spread throughout the rest of the national economy is now strongly questioned.

While conventional arguments for concentrating investments in large metropolitan centers – i.e., that they provide greater economies of scale – may be valid for many high-techology, capital-intensive and export industries, and for massive modern infrastructure projects, these are only a small part of the investments needed to promote sustained and widespread economic development in many Asian countries. Once metropolitan areas reach two or three million in population it is not clear that they have unique advantages for a whole range of small- and medium-scale processing, commercial, service and manufacturing activities that could be located in smaller cities, or that they generate sufficient benefits through employment to outweigh their social costs.(13)

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Table 3

NUMBER AND POPULATION OF SECONDARY CITIES IN SELECTED ASIAN COUNTRIES

Country	Number of Secondary Cities, 1970 2/	Population (in 000s) 1970	1980	Percent of Urban Population 1970	1980	Percent Population Increase 1960-1970	1970-1980
Bangladesh	5	1,532	2,856	29.7	29.9	31.0	86.4
Burma	5	1,029	1,536	16.2	16.1	63.5	49.3
China 1/	137	91,615	--	51.8	--	56.4	--
India	135	45,482	68,958	42.5	44.6	59.8	51.6
Indonesia	26	8,980	12,531	44.0	40.0	43.1	39.5
Korea, North	8	1,940	3,171	27.8	29.6	118.2	63.4
Korea, South	17	6,130	10,152	48.0	40.6	91.3	65.6
Malaysia	4	770	1,100	27.2	26.7	99.5	42.9
Pakistan	15	6,077	10,025	40.4	42.8	49.4	64.9
Philippines	15	2,629	4,153	21.2	21.9	127.8	57.9
Thailand	1	111	237	--	3.4	--	113.5

Source: Compiled from United Nations, Patterns of Urban and Rural Population Growth, Population Study 68, (New York: Department of International Economic and Social Affairs, 1980), Table 48.

1/ Data for 1970 from Kingsley Davis, World Urbanization 1950-1970, Berkeley: University of California, 1969.

2/ Secondary cities defined as those with 100,000 or more population other than the largest city in the country.

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Potential Benefits of a System of Secondary Cities

The second contention is that secondary cities and regional centers in Asia, where they exist, can and do perform important functions in promoting regional development and in supporting the services, facilities and productive activities needed for widespread economic and social development. If strengthened in appropriate ways, secondary cities can play an important role in absorbing population and relieving pressures on the largest metropolitan areas. If agricultural development is to take place in Asia, then investment in agricultural processing and agribusiness will be necessary, farm-to-market roads and arterial highways in rural areas must be improved, inputs must be made available to farmers at convenient locations, markets must be created or strengthened throughout the country, and supporting services must be extended to cities and towns that are within easy reach of farm households and rural villages. Secondary and intermediate-sized cities can play an important role in stimulating rural economies, establishing a pattern of step-wise migration and, perhaps, providing the conditions for polarization reversal.(14) The contention of conventional economic growth theory that smaller cities and towns are inefficient and uneconomical locations for investment has never been proven.(15) Although a great deal more research needs to be done, some studies of India indicate that economies of scale for most urban services and utilities and for most support services for small and medium scale industry are reached in cities of about 130,000 in population.(16) Moreover, research on the costs of providing urban services in South Korea shows that they decline with population size-class to about a half million, and then begin to rise along a U-shaped curve for cities of smaller size. However, the marginal costs of providing services seem to be consistently lower in cities with populations larger than 50,000 than in Seoul.(17)

The evidence suggests that development of a few major industrial urban centers is unlikely to have the same impact on coping with the problems of Asian overpopulation as would a well-developed system of secondary and intermediate-sized cities which can provide a stronger spatial framework for encouraging a more balanced pattern of urban and rural development.(18)

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Roles of Secondary Cities and Towns in National and Regional Development

Recent studies of secondary cities and regional urban centers in Asia, and in other parts of the developing world, indicate that they play important roles in supporting agricultural and rural development, essential social services and facilities and small and medium scale industries. Moreover, many provide important markets for agricultural and manufactured goods and opportunities for off-farm employment. In much of Asia market centers with as few as 20,000 to 70,000 population play important roles in rural economies of their regions as market, commercial and administrative centers.(19) Many cities of 100,000 or more residents act as central places for the "decentralized concentration" of investments in a wide range of agroprocessing, manufacturing, commercial and infrastructural functions. The more important functions of these secondary and intermediate-sized cities may be listed as follows:(20)

1. They provide convenient and efficient locations for decentralizing public services, thereby offering greater access for both urban and rural residents to public services and facilities. Cities such as Chiengmai in Thailand(21) and Zamboanga, Tacloban, Legaspi and Cotabato in the Philippines function as regional administrative and service centers.(22)

2. They offer economies of scale which allow a reasonable concentration of basic and intermediate-level health, education, social and municipal services, acting as regional or provincial centers for a variety of public facilities. Indonesia's secondary cities – Surabaya, Medan, Ujung Pandang and Pedang – play such roles(23) as do Legaspi City, Iloilo, Zamboanga and other regional urban centers in the Philippines.

3. Secondary cities and towns such as Davao in the Philippines(24) and Ranchi in India(25) offer a wider variety of basic household and consumer goods, commercial and personal services, and opportunities for off-farm employment in both the formal and "informal" sectors that can be found in small towns and villages.

4. Many secondary cities and towns – such as Meerut and Ranchi in India and Naga and Dagupan in the Philippines(26) – act as regional marketing centers offering a wide variety of distribution, transfer, storage, brokerage, credit and financial services and important outlets for the sale and distribution of

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agricultural goods grown in surrounding areas.

5. The population growth and economic disversification of secondary cities and towns creates new demands for cash crops grown in the rural hinterlands. This has been clearly illustrated in studies of changes in cropping patterns and land uses in agricultural areas surrounding Lahore, Pakistan.(27)

6. Many small towns provide conditions that are conducive to small- and medium scale manufacturing and to artisan and cottage industries which service local markets with low-cost consumer goods. Some large secondary cities like Kaohsuing, Taichung and Tainan in Taiwan,(28) and Masan, Ulsan, and Daejeon in Korea also support large industries which provide substantial employment for their own residents and for migrants from other towns.(29)

7. Cities of the size of Chiangmai in Thailand, Meerut in India and Cheonan and Mogpo in South Korea act as agro-processing and agricultural supply centers for fertilizers, seeds, cultivating and harvesting implements, irrigation components and pesticides for farmers in their regions.(30)

8. Secondary urban centers such as Iligan in the Philippines and Penang in Malaysia provide off-farm employment and supplementary income for people living in nearby rural areas, and provide additional income for household members remaining in rural areas through remittances earned by rural-based migrants from such areas.(31)

9. They often serve as regional centers of transportation and communications, linking their residents and those of nearby rural areas to large cities and other regions of the country.

10. Many secondary cities function as centers of social transformation: absorbing rural migrants who might otherwise go directly to the largest city or the national capital; accommodating and encouraging the integration of diverse social, ethnic and religious groups that help assimilate rural people into city life; and providing new economic opportunities for people seeking social and economic mobility.

The United Nations estimates that there were about 335 cities with populations of more than 100,000 in East and Southeast Asia in 1970. These cities had more than 150 million residents. The UN studies indicate that the number has increased to about 350 in 1980 and that their population grew by at least 35 percent to about 204 million. The Philip-

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pines, Pakistan, Korea, India and Indonesia all have relatively large numbers of cities with populations of 100,000 or more that might be strengthened to perform these functions more effectively (see Table 3). Bangladesh, Burma and Malaysia have a smaller number of secondary cities, but a large number of provincial or district capitals and marketing centers that might grow larger and more diversified with appropriate investments in these functions.

Obiously, not all secondary cities are generative and developmental. Nor do all Asian countries now have a sufficient number of secondary cities to provide a strong set of countermagnets to the largest metropolitan areas. But for many Asian countries still going through the process of urbanization, appropriate policies for secondary and small cities development could offer a feasible, long range alternative to the overconcentration of people and productive activities in one or two large metropolitan areas.

Polities for Secondary and Small City Development

Although countries as disparate in their political and economic characteristics as South Korea, the People's Republic of China, Nepal, the Philippines, Thailand, India, and Malaysia now have plans for coping with metropolitan growth and for reducing regional disparities by strengthening the economies of regional urban centers, few Asian countries have seriously attempted to pursue alternatives to metropolitan growth in the past. Thus, there is little real experience on which to base future development plans and policies.

However, studies of the characteristics of secondary and small cities, and of the attempts at controlling the growth of large metropolitan centers, do suggest broad guidelines for formulating strategies: (32)

First, it is clear that the creation of a few major industrial growth poles in remote rural regions, or industrial satellite cities around existing metropolises — as some governments attempted during the 1950s and 1960s — has little effect on the growth of primate cities The former approach either fails to promote economic diversification or encurages the development of urban enclaves that have little linkage with the rural economies that surround them. The latter often promotes the growth of cities which are themselves quickly absorbed into an

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expanding metropolitan region and this exacerbates the problems of overconcentration. However, strengthening the economies of such secondary cities by strong linkages to their rural hinterlands may have a far greater influence on balancing urban development and economic growth.

Second, few controls on the growth of large metropolitan areas or incentives for the deconcentration of economic activities located within them are likely to be effective unless there are viable alternative locations at which high-threshold economic activities can operate efficiently and profitably. Businesses and industries that depend on large markets, efficient transportation and communications, professional skills and trained managers, reliable utilities and administrative and political contacts will either avoid or absorb the higher costs imposed by controls unless alternative locations provide the requisite conditions. Moreover, attempting to force people and economic activities to remove from large metropolitan centers before other locations can efficiently support them can be detrimental to the national economy. Strengthening the system of secondary cities may thus be a prerequisite for effective controls on primate city growth or for incentives for industrial deconcentration.

Third, experience suggests that if the secondary cities that are selected for development are not themselves to become enclaves that drain the resources of their surrounding rural areas, the economic activities fostered within them must be closely related to the agricultural economies of their rural hinterlands. Studies of the economies of secondary cities suggest that investing in small- and medium-scale service, distribution, commercial, marketing, agroprocessing and local resource-using, labor-intensive, production activities is more likely to stimulate development in the regions in which they are located. Spread effects and beneficial interaction do not flow automatically from the growth of cities of any size. Their economies must be structured in ways that are likely to stimulate regional production and demand and raise the incomes of peoples living in the region.

Fourth, because most Asian governments have limited investment resources, the strategy must often be carried out incrementally, starting with existing secondary cities that have clear growth potential. The goal of investment in such cities should

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be to a) extend basic social services and municipal facilities that support productive activities; b) improve physical infrastructure to make these cities more conducive to productive economic activities; c) stengthen existing or potential comparative advantages; and d) improve the planning, administrative and financial capacity of their local governments.

Fifth, stimulating the growth and diversification of suitable smaller towns and market centers in order to increase the number and geographic distribution of potential secondary cities within the national settlement system is also an important factor in urbanization policy. Improvements that strengthen their functions as commercial, service, agricultural marketing and small-scale industrial centers will help them to support a wider diversity of employment generating activities.

Sixth, attention must be given to improving transport, marketing, service, communications and administrative linkages *between* large metropolitan centers, secondary cities with growth potential, and selected smaller cities and market towns. Effective physical and economic linkages create the potential for mutually beneficial economic interaction.

Continued urbanization in Asia is inevitable. The growth of cities *can* be a positive force in reducing fertility and population growth rates as well as in stimulating economic growth during the remaining years of the twentieth century. Similarly the continued concentration of people and economic activities in vast megalopolitan areas will generate serious economic and social problems that might be avoided or alleviated by the growth of smaller cities and towns in rural regions. As the strains of large-scale metropolitan growth in Asia become more visible, and as the social and economic costs become more obvious, attempts to develop secondary cities and towns as alternatives to megalopolitan growth become increasingly fesaible from a political as well as an economic point of view.

FOOTNOTES

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(3) Jean Gottman, "Megalopolitan Systems Around the World," in L.S. Bourne and J.W. Simmons (eds), *Systems of Cities,* (New York: Oxford University Press, 1978): 53-60.

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(4) World Bank, "Poverty," Shelter, Poverty and Basic Needs Series (Washington: World Bank, 1980), p. 3.

(5) Michael Spector, "Seoul: Too Big for its Own Good," *Far Eastern Economic Review,* 124 (May 3, 1984): 30.

(6) See Dennis A. Rondinelli and Kenneth Ruddle, *Urbanization and Rural Development: A Spatial Policy for Equitable Growth,* New York: Praeger, 1978.

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(10) World Bank, *Urbanization Sector Working Paper,* Washington: World Bank, 1972: 4.

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(14) For a more thorough discussion of the conditions for polarization reversal see Harry W. Richardson, *City Size and National Spatial Strategies in Developing Counties,* World Bank Staff Working Paper No. 252, Washington: World Bank, 1977.

(15) See, for example, Koichi Mera, "On the Urban Agglomeration and Economic Efficiency," *Economic Development and Cultural Change,* 21 (1973): 309-324.

(16) Stanford Research Institute, "Costs of Urban Infrastructure for Industry as Related to City Size: India Case Study, ' *Ekistics,* 20 (1969): 316-320.

(17) Cited in Wong-Yong Kwon, "A Study of the Economic Impact of Industrial Location: The Case of Seoul," *Urban Studies,* 18 (1981): 73-90.

(18) See Dennis A. Rondinelli, "The Dynamics of Growth of Secondary Cities in Developing Countries," *The Geographical Review,* 73 (1983): 42-57; and D.A. Rondinelli, "Towns and Small Cities in Developing Countries," *The Geographical Review,* 73 (1983): 379-395.

(19) See Dennis A. Rondinelli, "Cities and Agricultural Development: The Urban-Rural Connection," *Regional Development Dialogue,* 5 (1984): 1-18.

(20) For detailed descriptions and examples see Rondinelli, *Secondary Cities in Developing Countries,* op. cit., Chapter 4.

(21) Chakrit Noranitipadungkarn and H.C. Hagensick, *Modernizing Chiengmai,* Bangkok: National Institute of Development Administration, 1973.

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(30) See Rondinelli, *Secondary Cities in Developing Countries,* op. cit., Chapter 4.

(31) R. Ulack, "The Impact of Industrializtion Upon the Population Characteristtics of a Medium-Sized City in the Developing World," *Journal of Developing Areas,* 9 (1975): 203-220.

(32) See Rondinelli, *Secondary Cities in Developing Countries,* op. cit., Chapters 5 and 6.

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A MONETARIST INTERPRETATION OF INFLATION IN PRE-REVOLUTIONARY IRAN

By Robert E. Looney

Inflation poses a grave threat to any political system. It does so because it succeeds in touching the lives of the ordinary citizen – not some, but all – in a way in which government development expenditures are rarely able. Whether it is hyper-inflation or gradual increases in prices over time, the damage done to the individual and society is evident. By creating an atmosphere of insecurity and futility, by permitting wholesale economic injustice and by giving rise to abject poverty, an environment is created which makes for irrationality in politics (1) and thereby deeply affects the nature and effectiveness of subsequent stabilization measures.

In retrospect the development of inflation in Iran, especially after 1973, together with the government's inability to stabilize the price level, undoubtedly was a major factor contributing to the success of the revolution against the Shah's government.

Green has noted that by 1977 (2)

> ...the problem was not purely political, but rather an outgrowth of the rapid decline in the Shah's development planning. As I argued earlier, the crisis of participation was transformed into a crisis of the system as a whole, in part as a consequence of the country's deteriorating economic situation. High inflation, unemployment and other issues ignited the population, not merely desires for greater political participation.

The nature of the Iranian inflation and the course of inflation related variables therefore merit considerable attention. In the following analysis particular emphasis is given to Iranian inflation in the 1970s, with an attempt made to identify the type and source of the inflation experienced.

In particular, an attempt will be made to test the monetarist approach to inflation in Iran. As will be shown in more vigorous fashion below, this approach is a logical one to use in examining price movements in pre-revolutionary Iran. First, the economy was relatively small in the sense that prices of goods and capital were determined in world markets, and over these Iran had

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little control. Second, even though Iran was considered a less developed country in the 1960s and 1970s, the country did have a relatively advanced financial sector headed by a central bank which over most of the period under examination, was responsible for influencing the external balance (the balance of payments) as well as domestic credit conditions. Thus, Iran provides not only the conditions necessary for testing a monetary model but also provides some interesting insights into the model's policy implications, especially with regard to the ment's stabilization efforts.

Inflationary Pressures – Overview

The Iranian economy enjoyed a prolonged period of price stability through the 1960s. Beginning in 1972, however, growing inflationary pressures developed and were present throughout the rest of the 1970s. During the Fourth Five Year Plan (1968-72), the annual rates of increase in the average level of consumer prices were low, ranging from 1 to 6 percent (Table 1). The corresponding rates of inflation for the Fifth Plan were on the other hand, all in excess of 10 percent, amounting to as much as 27 percent in 1977.

A comparison of the rate of increase in the money supply (Table 1) and that of the major inflation indices indicates that in the post-1973 period the Iranian economy had advanced beyond its absorptive capacity in the sense of finding the complementary factors of production (such as human skills, natural resources, and infrastructure) to be put to work alongside the rapid increase in financial resources. Apparently, injections of oil revenues beyond a certain level – that level being the annual absorptive capacity – only led to higher inflationary pressures with little or no corresponding increase in output resulting from this expenditure.

The evidence for Iran during the post-1972 period suggests a tendency to try to do too much in too short a time.(3) The problem was aggravated by the jump in international inflation rates during 1973-74. Yet it would be a mistake to suggest that the observed rates of domestic inflation were due to purely international factors. On the contrary most studies on the subject indicate that in general international price increases contributed no more than 25 percent to domestic inflation in developing countries, leaving a substantial portion to be accounted

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for by domestic factors.

Most domestic sources of the inflationary pressure build up in the mid-1970s can be traced to the decision to revise the Fifth Five Year Plan following the oil price increases. At that time, total investment projected for the duration of the plan was doubled and vast amounts allocated to social welfare and subsidy programs. Within the framework of the Fifth Plan the government's expenditures for 1974 were tripled compared to those in 1973. Of the total government budget for 1974 (R1s, 254 billion), only 28 percent went into fixed capital formation, whereas 58 percent was spent on current expenditures. The remaining 14 percent went for other payments which, for all practical purposes, were very similar to current expenditures.

This unprecedented expansion in government expenditures created a corresponding expansion of liquidity. The result was a rapid increase in effective demand. One net impact of the government's fiscal actions was the creation of an economic environment whereby producers were encouraged to make the utmost use of their means of production. Another consequence was that traders responded quickly by increasing imports to balance supply with demand. As a result, the demand for means of production and for primary and intermediate goods increased while simultaneously the available infrastructural facilities were used at maximum capacity. However, due to the general shortage of skilled workers and infrastructure capacity in certain key areas, the supply of domestically produced goods could not increase at the same rate as the demand. Inflationary pressures, therefore, mounted while at the same time the feedback effect of the oil price increases – an acceleration in world inflation – resulted in increased import prices.

Initially, the greatest inflationary pressures were concentrated in the construction and housing sector. Both the rapid increase in incomes and the increasing migration from rural to urban areas played an important role in creating shortages of not only available living quarters but construction materials (which was already evident prior to the Fifth Development Plan). The result was a sharp escalation in the price of land, construction materials, and wages of construction workers. In turn, the acceleration of inflation in the construction and housing sector spilled over to other sectors, finally increasing inflationary pressures in all other activities of the economy.

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TABLE 1

IRAN: GROWTH OF MONETARY AGGREGATES: MEASURES OF INFLATION

(Average Annual Rate)

	M1	M2	M3	M4	CPI	WPI	GDPDF
1960	11.50	-	-	-	10.04	3.15	3.04
1961	-16.73	-	-	-	3.17	1.28	2.14
1962	22.72	24.94	-	-	0.72	1.27	-0.26
1963	12.96	16.22	-	-	0.17	0.18	0.79
1964	10.98	13.81	-	-	4.11	4.64	1.83
1965	12.87	13.01	13.30	13.09	2.06	3.33	-2.31
1966	10.07	12.48	13.83	11.19	-0.34	-1.18	-0.52
1967	14.92	16.07	16.48	16.35	1.52	0.17	-0.79
1968	7.86	13.43	12.09	14.89	0.67	0.66	0.53
1969	6.07	15.07	14.76	17.94	3.64	2.61	0.52
1970	12.78	15.23	16.36	19.06	1.59	2.84	0.52
1971	17.17	19.36	19.82	18.33	4.24	5.79	7.27
1972	27.71	26.07	26.89	21.28	6.49	5.46	6.78
1973	22.93	23.25	24.93	25.35	9.76	10.11	31.79
1974	27.09	29.97	36.11	37.27	14.30	14.47	55.67
1975	16.76	25.79	21.59	25.09	12.74	7.40	10.38
1976	44.25	44.88	42.53	42.34	11.29	8.26	16.90
1977	-23.01	-26.09	-25.77	-25.70	27.31	14.65	19.50

Source: Computed from: Bank Markazi Iran, Annual Report, various issues; International Monetary Fund, International Financial Statistics, various issues.

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As bottlenecks began to develop, the time lag in converting financial capital into productive capital lengthened, further impeding the adjustment of supply to demand, with increased shortages of materials and skilled labor. Many projects, both public and private, were not completed despite the fact that in many cases the budgets for these projects were actually spent. At the same time, a considerable volume of goods ordered from abroad did not arrive on time. As a result of these factors, aggregate supply was never able to catch up with aggregate demand during the Fifth Plan, the adjustment between demand and supply taking place instead through price increases.

Needless to say, the overspending of financial resources represented not only a loss in real resources with intertemporal implications, but also set in motion a series of inflationary pressures which were difficult to halt without the eventual resort to fairly drastic restrictive measures. The real resources lost – real in the sense that they represented an equivalent in exported barrels of oil – were resources that could have been used in the future to expand the country's productive capacity at a time when the relationship between the economy's annual financial inflow and annual absorptive capacity would permit it. When used in the present, as was the case, these resources were simply dissipated in the form of higher prices.

Other sources of inflation are of course logically possible and not inconsistent with the data on price changes that is available for this period.

While few would challenge in principle, the broad interpretation of Iranian inflation outlined above, its high level of generality makes it of somewhat limited use in evaluating the effectiveness of the government's anti-inflation programs.

The increase in the rate of inflation in the first half of the 1970s together with the government's seeming inability to stabilize the price level dramatized the need for a deeper understanding of the country's inflationary process. Something of a debate concerning the precise cause of the rapidly accelerating price level transpired during this period. In particular the role of money and of monetary policy in controlling increases in domestic price was a commonly debated topic in planning areas.(4)

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Role of Money

The role of money(5) and monetary policy has of course been one of the often debated issues not only in Iran but in most developing countries for a long time. Despite Schumpeter's(6) dramatization of money and credit as a "phenomenon of development," the nature of monetary policy remained indistinct and ill-defined in Iran for two reasons. for one thing monetary policy was viewed in a narrow perspective as influencing aggregate spending via the regulation of interest rates, credit availability and credit allocation. For another, views on the role of money and monetary policy were dominated by the then prevailing perception by the government of the growth process itself, which had not assigned a meaningful function to money but rather emphasized the role of oil-financed physical capital accumulation.

The lack of interest in Iran in monetary aggregates and monetary control largely stemmed the excessive preoccupation of the economic policy makers with techniques of monetary management, reflecting an emphasis on cyclical rather than long run objectives, and on the deficiencies of these techniques for Iran.(7) For instance it was not considered effective for the central bank to manipulate bank (discount) rates as an instrument of policy because there were no market instruments or traditions among banks to react to bank rate changes in a definite and predictable fashion: open market operations were not thought to be feasible because there were insufficent government bonds for the Bank Markazi buy and sell on a large scale.(8)

Clearly, the issue of whether Iran's inflation was the consequence of the upward push of costs or the upward pull of demand on prices is important largely from the difference between the recommendations for anti-inflationary policy; i.e., the demand-pull explantion leading to the recommendation of monetary restraint and controlled levels of government expenditure, and the cost-push explanation leading to the rejection of macroeconomic measures of this sort in favor of policies related to tethe process of price formation and wage determination.

The difference in policy recommendations was not entirely a difference between right wing conservative and liberal technocratic solutions. Nevertheless, the two schools of thought did

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differ fundamentally over policy, one school (the monetarist) recommending measures involving a higher volume of unemployment in order to stop inflation,(5) the other (the government) preferring repressive measures that sought to restrain inflation without sacrificing growth or unemployment (both schools were united in their belief that inflation should be stopped, a conviction that became increasingly strong by 1977).

As in many instances in Iran, the economic issues surrounding the control of inflation became so closely bound up with political issues that, for some writers at least, it is difficult to determine whether the economic analysis preceded the policy recommendations or vice versa. Rather than survey the writings of each position therefore, the key aspects of both will be referred to selectively in the discussion that follows.

Suffice it say that in terms of numbers, those who thought that attempts to control the money supply were a useful and production endeavor were quite in the minority. The predominent view among most officials in the country was that the scope for demand management was severely limited for two reasons:

1. The nonpolicy disturbances to which monetary policy must respond invariably originated in the supply side (weather, bad crops, etc.) or abroad (changes in oil revenues) so that policy efforts to change domestic demand were of little or no consequence in their net effect on output and employment. Instead, the conventional wisdom in Iran was that the country's employment and growth was more closely related to the pace and nature of the economic development budget contained in the five year plan; i.e., the state of aggregate demand was given little recognition in this regard.

2. Coordinating supply and demand (equating savings and investments, etc.) is the central task of markets. The more complex an economy becomes (i.e., the more indirect are the economic relationships between members of a society), the more difficult this coordinating task is and the more sensitive these relationships are to disturbances. Here the conventional wisdom maintained that because the economy was by its very nature relatively uncomplex in this sense (retaining a high degree of barter), the coordination of supply and demand was without meaning, and consequently attempts to "fine tune"

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TABLE 3

TRAN: MONETARY DETERMINANTS OF INFLATION, 1959-1977

Equation	Dependent Variable	Independent Variables								Intercept	r^2	F
		GM2L	GM2L2	INFCL	GNOXNP	WINF	GM2	ZAG	DTNOXPL			
1	INFC	0.80 (0.03)								-9.19 (-6.09)	0.928	142.51
2	INFC	0.67 (7.17)	0.26 (1.72)							-11.42 (-6.01)	0.945	85.40
3	INFC	0.50 (3.67)	0.51 (2.48)				-0.09 (-1.66)			-10.87 (-6.09)	0.958	67.82
4	INFC	0.76 (8.39)	0.59 (2.91)	-0.57 (-2.12)						-16.15 (-5.83)	0.963	78.31
5	INFC		0.93 (10.16)		-0.63 (-1.93)		0.12 (1.74)			-7.20 (-3.30)	0.950	56.51
6	INFC	0.61 (7.57)	0.41 (2.96)		-0.41 (-2.53)	0.10 (1.20)				-8.98 (-5.05)	0.972	68.77
7	INFC	0.75 (9.06)	0.62 (3.34)	-0.67 (-2.66)		0.14 (1.71)				-16.78 (-6.61)	0.973	71.92
8	INFC	0.65 (7.49)	0.31 (2.19)			0.07 (0.70)		-40.88 (-1.81)		-9.55 (-4.83)	0.964	53.40
9	INFC	0.86 (-1.01)	0.69 (2.36)	-0.62 (-2.09)			-0.17 (-1.21)		0.007 (-0.51)	10.26 (3.20)	0.118	1.47
10	INFC	0.81 (10.66)					0.01 (0.20)			-9.47 (-4.54)	0.929	65.06
11	INFC	0.65 (2.92)	0.23 (1.03)						0.002 (0.14)	-10.62 (-1.74)	0.945	51.35

Note: See text for identification of symbols.

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demand by the authorities would be of little avail.

The Monetarist Approach to Inflation

The monetary approach to inflation in Iran starts with the fundamental proposition that inflation is merely an interaction of market supply and demand for money. Put differently, price movements are viewed by this model as systematically dependent upon current and immediate past evolutions of the interaction between supply and demand conditions.

The starting point of this analysis is the basic monetarist model derived from the equation of exchange.(9) More specifically, assume a simple money demand function of the following form:

(1) $M/PY = Y^{a}C^{b}$

where M is the (exogenously determined) nominal stock of money; P is the price, and Y is a measure of real income, and C is the expected cost of holding real balances. Equation (1) is solved for P and expressed in terms of growth rates (or depicted by G prefixing the variable): (2) INF = RM - (1-a)GY - bGC.

Equation (2) incorporates the basic elements of the monetarist approach to inflation: money, real income, and the expected cost of holding real balances. In addition, this formulation captures the basic methodological bias of the monetarist school; i.e., the equation has a limited number of variables, and the nature of relationships is clear and straightforward. The growth of money relative to output and cost of holding real balances will generate an increase in the rate of inflation. The growth of real income will cause decreases in the rate of inflation (via absorbing money in the increased demand for real balances). Similarly, the rate of inflation is assumed to be inversely related to the expected cost of holding real balances.

Equation (2) assumes instantaneous adjustment of monetary changes and no money illusion. Therefore, the tested form of the monetarist equation is:

INF - a + a1GM + a2GML + GML2 - GNOXNP + EXP

where GNOXNP is growth of real non-oil income; GML is the growth of the money supply lagged one year; GML2 is the growth in the money supply lagged two years, and EXP is some measure of inflationary expectations.

The basic monetarist contention is: 1) that the causal relation runs from money to prices and output; 2) any persistent

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TABLE 2

IRAN: MONETARY DETERMINANTS OF INFLATION, 1959-1972

Equation	Dependent Variable	Independent Variables								Intercept	r^2	F
		GM2L	GM2L2	INFCL	GNOXNP	WINF	GM2	ZAG	DINOXPL			
1	INFC	0.66 (2.19)								-7.01 (-1.62)	0.445	4.81
2	INFC	0.62 (2.79)	0.85 (2.46)							-19.00 (-3.28)	0.749	7.45
3	INFC	0.05 0.26	0.62 (3.39)				0.36 (3.94)			-13.21 (-4.03)	0.949	24.68
4	INFC	0.87 (4.02)	1.07 (3.62)	-0.61 (-1.99)						-24.64 (-4.57)	0.874	9.24
5	INFC		0.55 (1.32)		-0.47 (-1.92)		0.34 (2.50)			-6.77 (-2.30)	0.897	11.60
6	INFC	0.71 (3.62)	1.01 (4.23)	-0.81 (-3.04)		0.26 (1.82)				-21.70 (-4.73)	0.940	11.80
7	INFC	0.53 (2.14)	1.09 (3.20)			-0.04 (-0.23)		-64.39 (-1.93)		-17.00 (-2.88)	0.892	6.17
8	INFC	0.45 (1.48)	0.70 (2.16)	-0.41 (-1.49)					0.043 (1.73)	-12.42 (-1.49)	0.937	11.15
9	INFC						0.47 (4.88)			-4.63 (-3.08)	0.799	23.89
10	INFC		-0.80 (-0.26)				0.47 (3.00)			-3.94 (-1.25)	0.802	10.12
11	INFC	0.15 (0.58)	0.44 (1.41)						0.05 (2.27)	-4.89 (-0.64)	0.890	10.83

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increase in money relative to output is a sufficient condition for inflation; 3) the magnitude and length of inflation is dependent on the magnitude and persistence of monetary growth; 4) the occurrence of inflation is independent of the level of employment in the economy, and 5) it is the increasing growth rate of money which yields inflationary pressures.

The results of the monetary regressions on the rate of increase in the consumer price index indicate that the monetarist model performs extremely well. Both the growth in M1 and M2 were used, with M2 performing slightly better. M2 by itself, however, is not significant when lagged one year.

GM2L is highly significant explaining nearly 45 percent of the observed rate of inflation (equation 7, Table 2). When combined with MG2L2, expected inflation INFC (lagged one year) and world inflation WINF, GM2L explains 94 percent of the variance in INFX. In general, the growth of world prices gives somewhat better results than world inflation lagged one year. The growth in non-oil GDP does not significantly contribute to the regression equation when introduced with lagged GM2 nor does the deviation from the trend of real non-oil income.

Openness measures (ZLON) are significant and of the right sign when regressed with GM2L and GM2L2. They are right on the border of acceptability, however, but do improve the r^2 somewhat further.

The negative sign on the inflationary expectation term (INFCL) as proxied by last year's rate of inflation is of interest and has certain implications for monetary policy. The negative sign indicates that, with increased inflation, individuals may have actually increased their holdings of money. An apparently irrational move since inflation was eroding the value of these holdings at the time. This however can to some extent be explained by the financial structure of the country, which can be characterized by;(10)

1. greater reliance of firms on internal financing than on the issuance of new securities;
2. only limited activity in the domestic stock exchange with new securities being mainly purchased by the financial institutions rather than the non-bank private sector, and;
3. deposits with the monetary system constituting the

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major portion of the public's claims on the financial intermediaries.

The lack of developed markets where borrowers and lenders could interact directly, together with a lack of confidence in the stability of the country's financial markets and the inadequacy of government regulations for dealing with fraud in the stock markets apparently made broad money (M2) the most desirable asset to hold during this period. The reason for the desirability of money despite the fact of rapidly rising prices at the time must have been due to the fact that individuals perceived it a relatively riskless asset in the short run.(11)

When the results for 1959-72 (Table 2) are compared with those for the period as a whole (Table 3), several differences appear.

1. In general, the monetary impact is not as strong (based on r^2 values).

2. The monetary impact came sooner in the 1959-73 period with GM2 significant then, but not for the period as a whole.

3. In general, the coefficient for money lagged one year was quite similar for both the periods (except when included in regressions with GM2).

Tentatively there is no real evidence here that a fundamental structural shift occurred after 1972. Monetary variables seem to have played a predominant role in influencing the movement in the country's price level before and after the oil price increases.

Conclusion

It is fair to say that in the 1970s most Iranians considered inflation to be an economic malady of sorts. This suggests approaching the study of inflation in the same way that the medical profession approaches the study of other diseases. One thing we can learn from them is that it pays to concentrate at first on certified, known, unambiguous causes of the disease.

Based on the above analysis(8) of monetary movements, it is clear that any meaningful framework for the analysis of inflation in Iran must systematically take into account the role of money in the economy. The link between real expenditures and monetary increases would seem to be the key element. Real demand in the country is determined in part by factors that depend on aggregate supply and in part by factors that are

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determined independently of supply. An approach along these lines might assume that the factors that bring demand and supply into balance are ultimately responsible for the economy's domestic price changes.

It is interesting in retrospect that in nearly every year after 1970, the Bank Markazi Iran (The Central Bank of Iran) Annual Report made some statement to the effect that inflation in the country was a problem of excess monetary demand. Typical of the bank's approach was the implicit application of Fisher's version of the quantity theory of money; i.e., in 1975 the bank noted that:(12)

> During recent years, due to the very speedy growth of income the total demand increased at a higher rate than total supply of goods and services. This situation not only resulted in creating new difficulties for the economy, but also increased inflationary pressures During recent years, especially in 1973, due to the expansionary financial activities of the Government and the speedy growth of credits extended by the private sector, the money supply and consequently the effective demand increased at a much higher rate than could be accommodated by domestic production.

We find in their reports, therefore, that the Bank accepted a model which usually implicitly but sometimes explicitly linked inflation with monetary factors. Furthermore, a careful reading of the Bank's reports leads one to conclude that its senior economists tended to view the economy as one where aggregate demand was determined by factors associated with Fisher's version of the quantity theory of money.(13) Specifically, in recommending policies designed to assure monetary stability, the Bank implicitly assumed that the economy's prices and wages were, for the most part, flexible. Stabilization measures suggested by the Bank at one time or another included:

1. restrictive monetary policies
2. restrictions on government expenditures (mainly government consumption expenditures)
3. reduction of import controls
4. lower wage and salary adjustments (presumably limited to less than the previous year's inflation rate)

Nowhere in the Bank's analysis of the country's inflation is there any evidence that its officials felt the underlying structure

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of the economy prevented high and steady rates of economic growth with price stability, provided the proper monetary and fiscal policies were implemented.

Ironically the Government's approach to stabilization of the price level apparently rejected this analysis and instead consisted for the most part in the implementation of various anti-profiteering campaigns involving direct state action.(14) For example in the 1975 anti-profiteering campaign more than 250,000 businesses were briefly closed, over 8,000 shopkeepers were jailed, and another 23,000 shopkeepers and merchants were sentenced to deportation (later rescinded to remote areas of the country.)

Governmental measures in 1977 to reduce inflation through the imposition of credit controls set off a major deceleration of the industrialization program. As a result of this stabilization program, the construction industry, a major source of employment for unskilled rural labor, underwent a severe contraction in 1977 with the rural migrants as a whole suffering the greatest decline in living standards because of the continuing inflation. The bazaar merchants, dependent on state credits to finance many of their activities and affected by the inflation, came to feel by 1977 their economic role in society increasingly threatened by the pattern of development that was gradually narrowing their possibilities for private capital accumulation and upward social mobility. Finally, local industrialists joined the merchants to express their opposition to price controls, anti-profiteering campaigns and an endless series of government decrees placing limits on capital accumulation and expansion.

Little wonder the revolution saw a mass uprising against the regime. Given that the monetary sources of inflation were early the Central Bank, and that fairly easily implemented stabilization were then efforts suggested by the Bank (that most likely would have been successful), the question arises as to why the regime failed to take this advice into account and instead continued to proceed with various restrictive decrees and anti-profiteering campaigns. One answer has been suggested by Green:

> ...mobilization systems create expectations that cannot possibly be met. Significantly, as we shall see in the Iranian case, a denial of participation can be linked with virtually any issue, whether it is particularistic or of wide

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social consequences. High taxes, low income, inflation, repression, or unemployment can all be attributed to the absence of popular input into the state. The mobilization regime alerts a populace that there is such a thing as participation, that it is important and desirable, and perhaps most significantly, that this input is needed by the regime and will be subsequently sought. Such a process is self-defeating, for by its very nature a mobilization regime is unable to sanction or even assimilate potentially critical input without having to change its character – something such regimes generally resist.

Footnotes

(1) Brian Griffiths, *Inflation: The Price of Prosperity* (New York: Holmes & Meier, 1976), p. 3.

(2) Jerrold D. Green,*Revolution in Iran: The Politics of Counter Mobilization* (New York: Praeger Publishers, 1982), p. 63.

(3) Firouz Vakil, "Iran's Basic Macroeconomic Problems: A Twenty-Year Horizon," *Economic Development and Cultural Change* (July 1977), p. 722.

(4) Cf. the account given in N. Keddie, "The Midas Touch: Black Gold, Economics and Politics in Iran Today," *Iranian Studies* (August 1977), pp. 343-66.

(5) For a clear concise statement of the theory together with its contrast to other views on the inflationary process, see Harris Johnson, "Monetary Theory and Policy," *American Economic Review* (June 9162), pp. 335-384.

(6) J.A. Schumpeter, *The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest and the Business Cycle,* translated version by Redvers Opie (Cambridge: Harvard University Press, 1934).

(7) For an early criticism of this narrow view of the development process, see Richard Benedick, *Industrial Finance in Iran* (Cambridge, Massachusetts: Harvard University Press, 1964).

(8) Ibid., Chapter 7.

(9) The formulation used follows that developed by A. Harberger. Cf. Arnold Harberger, "The Dynamics of Inflation in Chile," in C. Christ, ed., *Measurement in Economics* (Stanford, California: Stanford University Press, 1963), pp. 219-250.

(10) Cf. Benedick, op. cit.

(11) R. McKinnon has developed a theory of monetary policy around this type of situation. Cf. R. McKinnon, *Money and Capital in Economic Devclopment* (Washington: Brookings Institution, 1973), p. 38.

(12) Bank Markazi Iran, Annual Report, 1975 (Tehran: Bank Markazi, 1975), p. 69.

(13) For a discussion of the Fisher theory as relevant for developing countries, cf. Militon Friedman, "Monetary Policy for a Developing Society," Bank Markazi: Iran, *Bulletin* (March-April 1971).

(14) An excellent account is given F. Halliday, "Iran: The Economic Contradictions," *MERIP Reports* (July-August), 1978.

(15) Green, op. cit., p. 8.

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SUBSIDIZED HEALTH CARE AND CONSUMER CHOICE

By Howard R. Bloch and Roger L. Pupp

Professor Alain Enthoven has developed an exciting alternative to health care financing in America which he believes could moderate the yearly increases in medical care costs and expenditures (Enthoven: 1979, 1980, 1981). His approach, called the Consumer Choice Health Plan (CCHP), involves three fundamental changes to the current system of health care financing: a) to encourage universal health insurance coverage, independent of job status, tax credits will be employed to subsidize the purchase of health insurance provided individuals purchase coverage from a qualified health plan (QHP), b) a requirement that QHP's provide a basic list of medical services, and c) that QHP's must conduct annual open enrollment and use community rating (CR) to set premiums. Certification of QHP's, CR and annual open enrollment would be monitored by a new state/federal regulatory agency.

In this paper, we will analyze the advantages and disadvantages of CR. While basically we agree with Enthoven's approach in CCHP, we argue that CR is not needed to achieve the limited overhaul of the health care system which Enthoven desires, and may well cause some undesirable side-effects that Enthoven either ignores or does not recognize.

The remainder of this paper is organized as follows. In the first section, background information on the current method of health care financing in America is presented, illustrating some of the problems which Enthoven's plan is intended to ameliorate. The list of services to be included in a QHP is delineated in the ensuing section. Our major purpose is to analyze the role of CR in CCHP, so these early sections serve as an introduction to the discussion of the effects of CR, which are carefully analyzed in section three. The last section presents a summary and recommendations.

Universal Coverage and CCHP

While almost all of the aged receive Medicare or Medicaid, and many of the poor (both non-working and working) are eligible for Medicaid, a worker's health insurance is typically

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TABLE 1

ABBREVIATIONS USED IN THIS ARTICLE

1) Blues – Blue Cross/Blue Shield Plans

2) CR – Community rating: An insurance premium rating system under which all policy holders in a group or community pay the same premium, which equals the anticipated average cost of servicing the group.

3) CCHP – Consumer Choice Health Plan: An approach to health care financing developed by Professor Alain Enthoven to improve the efficiency and lower the cost of health care delivery in the United States.

4) ER – Experience rating: An insurance premium rating system under which each individual pays a premium which is determined by his or her risk characteristics.

5) HMO – Health Maintenance Organization: An organization providing (at least) basic physician and hospital services to an enrolled population for an advance capitation.

6) QHP – Qualified Health Plan: Any health insurance plan that meets Enthoven's broad standards for inclusion in the CCHP.

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subsidized (partially or completely) by the employer. Contributions for health insurance are, of course, totally deductible as business expenses of the firm, and they are not included as taxable income in either the employee's Social Security or payroll taxes.(1) Also, there is no limit on the amount that the employer may deduct for such contributions. Current tax policy decreases the marginal cost of health insurance, since the employee is, in effect, allowed to purchase it with before-tax rather than after-tax income.(2) The decrease in the cost of a given dollar amount of insurance accelerated during the inflationary period of the 1970s, as taxpayers were pushed into higher marginal tax brackets. As one would expect, consumers purchase more complete coverage as the cost drops. Feldstein (1971, 1973) argues that complete coverage led to overinsurance and a welfare loss of $4 billion, or about 32% of private hospital expenditures, in 1969. Furthermore, he estimates that increased insurance coverage is the cause of over half of the observed medical care inflation.

While Feldstein is concerned that lack of cost-sharing leads to medical care inflation, Enthoven maintains that copayments have not held down price inceases.(3)

> According to Feldstein and Taylor (1977), consumers directly paid 29 percent of total hospital costs in 1960, 17 percent in 1970. Consumers paid 35 percent of private cost in 1960, 27 percent in 1970. Yet total health services spending increased from 5.3 percent of GNP in 1960 to 7.6 percent in 1970. Hospital spending increased from 1.97 percent of GNP in 1960 to 2.83 percent in 1970. So coinsurance was tried and health care costs rose [6, 478-9].

Thus Enthoven's own study indicates that between 1960 and 1970, copayments decreased and prices and expenditures increased; this is exactly the relationship that Feldstein suggested, and it appears that in this case Enthoven is refuting his own hypothesis. Many authors have found that while the elasticity of demand for medical care is less than one, it is certainly greater than zero [13, 92-93]. This casts doubt on Enthoven's conjecture that copayments are ineffective in holding down prices and expenditures.

Enthoven dislikes insurance coverage attached to the workplace for two reasons. First, it has, as mentioned above, led to provider inefficiency, overinsurance and medical care inflation.

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Second, it has made it difficult for the temporarily and permanent unemployed to obtain and maintain coverage when not working, since a worker's coverage is usually dropped (by the employer) shortly after he leaves the payroll. As an alternative, Enthoven proposes a credit for health insurance to be offset against federal income tax liabilities, provided taxpayers buy coverage from a QHP. The advantages of a tax credit are: 1) it is not tied to the workplace, so non-workers would find it easier to maintain coverage, 2) it can easily be adjusted to increase subsidies to the poor or the aged and 3) it will provide more benefit than a deduction to those in low marginal tax brackets.

Enthoven's tax credit is based on the average cost of care in four risk categories within arbitrarily defined market areas, with each state (usually) being treated as a separate market. He proposes that the tax subsidy should be equal to 60 percent of the premium for a basic plan offered by a QHP, although the tax credit might rise to 100 percent for the poor. Since the amount of the subsidy is limited, people who want more extensive insurance coverage than is provided in a basic plan would have to pay all of the extra cost of the better plan. This feature is a cornerstone in Enthoven's plan to revamp the current medical care system. It is intended to encourage consumer cost consciousness, and (even more important) to motivate providers to increase efficiency in order to attract more customers. The cost saving generated by greater efficiency, he suggests, can be shared with customers by offering a lower premium and/or improved coverage [7, 147]. Unfortunately, as described below, the ability of any organization to pass along cost saving is limited by CR and annual open enrollment. We will return to this point after a short discussion of the requirements of a QHP.

Qualified Health Plans

Enthoven describes the minimum level of benefits required in a QHP as follows:

> A qualified health plan would be required to cover, at a minimum, the list of services called "basic health services" in the HMO Act of 1973 (as amended). That list includes physician services, impatient and outpatient hospital

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services, emergency health services, short-term outpatient mental health services (up to twenty visits), treatment and referral for drug and alcohol abuse, laboratory, and X-ray, home health services, and certain preventive health services [5, 127-8].

He mentions that this list may be amended, for example, by adding copayments or other services. Additionally, a QHP must provide a castastrophic stop-loss limit on out-of-pocket expenses (including copayments) of $1500 per year. (The limit is only suggested; Enthoven specifically mentions that the limit and list of services are negotiable.) Finally, insurance companies must agree to set premiums by CR and conduct annual open enrollment before their plans are certified as QHP's. Although it is not required, Enthoven expects that insurance carriers offering QHP's will offer some higher option plans in addition to their basic one, which would enhance consumer choice [5, 71 and 128].(4) However, the tax credit would cover only 60 percent of the cost of a basic plan, so that the extra cost of a higher option plan would be paid by the insured. As mentioned above, this part of Enthoven's plan is intended to encourage consumers to be more cost conscious, since they will bear the extra cost of a more expensive plan.

Community Rating and Cross Subsidies in CCHP

CR, a procedure under which everyone in a defined group is charged the same insurance premium regardless of individual risk characteristics, is required in CCHP. In health insurance, many factors affect individual risk including age, sex, family health status, smoking status, weight, and many others [2]. An alternative procedure, experience rating (ER), sets individual premiums by weighing the importance of each of the relevant risk factors for each person in determining probable health care utilization.(5) A high (low) risk individual is defined as a person who has an experience rate above (below) the community rate. The cross subsidy from a low to high risk is defined as the difference between the low risk's community rate and experience rate.

CR encourages firms to cream skim (that is, attempt to attract people whose claims are likely to be less than the premium they pay). If a given company is successful in insuring a disproportionate number of low risk individuals, the company

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will profit, but of necessity some other companies will be forced to take a higher ratio of high risk individuals, and may suffer losses or even go out of business. Ironically, it is CR that causes financial difficulties for some firms, regardless of the efficiency with which they are managed. Of course, a more efficiently managed QHP will have a higher probability of survival whether CR is employed or not.

Enthoven concedes that CR leads to cream skimming, and he suggests a modified form of CR that "can do a good enough job to make the remaining problems of incentives to select preferred risks quite manageable." [5, 121] Modified CR implies that some, but not all, relevant risk characteristics are used to set premiums. In CCHP, each QHP will be required to set regional (probably state) community-rated premiums for each of four groups, but will be allowed to adjust their CR's to reflect their particular financial situation. Accordingly, some QHP's that are managed more efficiently than others may well set lower CR's. The four groups are a) individual adults alone, b) individual adults plus one dependent (couples), c) individual adults plus two or more dependents (families), and d) the aged 65 and above. Enthoven mentions that additional risk characteristics may be employed to set premiums for the aged, and possibly later for the non-aged; however, he makes it quite clear that he is unequivocally ruling out ER. As evidence that modified CR would not result in excessive cream skimming, he says that, "The fact that the prototype HMO's used community rating for decades shows that it is entirely feasible." [5, 127].

It is true that CR is essentially the method by which rates are set in HMO's and other plans, but rates for HMO's are not set on a statewide basis as would happen in CCHP. Indeed, regional CR by HMO's and Blue Cross plans (Blues) has not proved viable. Earlier in the Blues' history, regional CR was tried, but quickly abandoned in the face of competitive challenges from commercial insurers, who offered larger firms an experience rated group plan for their employees alone [23]. Subsequently, experience rated group plans based on the collective risk of all employees within the firm became the standard and not the exception. While firms were offered experience rated group plans, the plans rarely went so far as to offer each individual employee an experience rate, because of a complex interaction between the transactions cost of setting premiums and the

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existing tax code which is discussed below.

Regional CR will provide the impetus for all QHP's (but especially profit-making carriers) to cream skim. Under regional CR, firms cannot offer the low risks a lower premium or, with annual open enrollment, refuse to accept high risks, but they can market and locate in areas with lower concentrations of high risk individuals. (Meyer [25] maintains that this already happens with HMO's under CR.) Action [1] and Phelps and Newhouse [27] have theoretically and empirically shown that time costs of travel reduce the demand for care. Consequently, the use of care by high risk individuals will be reduced when clinics locate further away from them, and the QHP will be somewhat insulated against possible financial problems caused by a disproportionate ratio of high to low risks. While relocation of clinics may well occur quietly and without protest under regional CR, we doubt that any legislator would publicly acquiesce to such a plan, if the effects were clearly articulated to the public.

CR makes competitive sense, if the cost of actuarially calculating experience rates for each employee in a group, plus other administrative charges is prohibitive. Specifically, if the experience rate plus the administrative loading is greater than the community rate for most people, then CR is economically efficient. (That is, CR is superior if the cross subsidy from the low to high risks is less than the potential administrative loading.) Blair and Vogel [4] estimate the administrative costs are 18.8 percent and 47.0 percent of premiums for group and individual health insurance respectively. Pupp [28] found that the average cross subsidies from low to high risks in a sample of individuals from three employer groups ranged from 18 percent to 33 percent. Clearly, most of the low risks have no incentive to opt for individual coverage at a fair actuarial rate (if offered), since the cross subsidy is less than transactions costs. (We are assuming that the cross subsidies found in Pupp [28] are representative of other plans.) While most low risks will not find it advantageous to remain in a community rate group plan, those low risks who pay a cross subsidy above 47 percent of the community rate might well prefer to leave. However, current tax lows only allow a deduction for employer payments of group health insurance (not individual) premiums. (6) Therefore, individuals will hesitate to leave a group plan, since em-

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ployers typically will not pick up the cost of individual coverage. CR "works" because of the curious nature of the tax code, but if CCHP were passed and the tax code changed, the appeal of CR would diminish. Therefore, analyzing the probable effects of CR under CCHP by analogy to current tax and CR policies is inappropriate.

Why does Enthoven require CR and annual open enrollment? He does so for three reasons, all of which we believe lack merit. First, he believes that low risks should pay for part of the cost of care of high risks;

> If it [CR] were not required, health plans could charge high premiums to high-risk persons, in effect making health insurance unaffordable to those who need it most. [5, 127]

We interpret this to mean that he believes high risks are probably low-income aged and unemployed and deserve extra aid. Second, he claims that people who fall into the high risk category do so involuntarily, although he admits this is a simplification [5, 80]. Third, he maintains CR is needed to avoid jeopardizing the financial integrity of QHP's through the strains introduced by free riders. We will indicate, in turn, why we believe each of these reasons fail to justify CR.

It is not necessarily true that high risk individuals are low-income earners or aged. There are many risk determinants other than age, income and working status, and no one factor individually is sufficient to qualify a person as either a low or high risk. However, Enthoven mistakenly concentrates on only two of the risk variables, age and employment status, to determine risk levels.

Interestingly, Huang et al. [20] discovered that low-income blacks were the low risks in a community rate group containing high income whites; the blacks cross subsidized the whites. Pupp [28] found age is positively related to greater use of medical care, but this factor alone was not enough to determine whether an individual was either a high or low risk. Also, it is a myth that there is a close relationship between advanced age and poverty status. Smeeding [33] discovered that 6.2 and 6.7 percent of the aged and non-aged are impoverished. Pupp et al. [29] estimated that only 7.4 percent of the low-income aged are below the poverty level.

We know of no study which separates low and high risks in a

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sample of an employed and unemployed insured population. Even if the unemployed are high risks (a dubious conjecture), CR would provide no advantage to them, since under Enthoven's tax credit scheme the working and non-working poor recover the full cost of their health insurance through a 100 percent tax credit.

Even if one accepts the widely (albeit not universally) held principle that the health care of the poor should be borne at least in part by the wealthy, Enthoven's plan would still appear to be a curious mixture of implicit and explicit subsidization.

A simple tax credit (an explicit government income redistributive technique) would have two major advantages: all poor people (both high and low risk) would be subsidized by all rich people, and the amount of health expenditures allocated to the poor could be regulated closely by the government. On the other hand, CR is an implicit government mandated income redistributive technique that imposes a "hidden" tax on a subset of private sector members, but yet does not appear in the federal budget as does Medicaid. This approach has a number of disadvantages. First, as cited above, low risks whether wealthy or poor subsidize high risks whether wealthy or poor. Second, in CCHP, CR occurs regionally, so that only low risks in each geographic area subsidize high risks in that area. Accordingly, low risks in Mississippi (for example) would subsidize high risks in the state. But Mississippi is our poorest state, so that an average risk in this state is less wealthy than their counterparts in other states. Other redistributive programs, Aid to Families with Dependent Children, Supplemental Security Income, and Medicaid, redistribute income from wealthier to poorer states, but with CR this would not happen in CCHP.

If Enthoven wants to subsidize health insurance for the poor, we have the following suggestion: allow QHP's to experience rate, and subsidize the poor with tax credits. ER eliminates hidden taxes, and allows QHP's to operate more competitively and efficiently in setting rates and attracting patients. The use of tax credits can be targeted to the poor only, and can exclude wealthy high risks.

The second reason Enthoven supports CR is his belief that being a high risk is a condition which is beyond the control of the individual. He admits that illness is a function of both involuntary factors (such as genetics and accidents) and unhealthy

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life styles, but maintains the two are not easily separated, but there is some evidence to which one can appeal. Zeckhauser and Zook [35] tabulated data from a number of studies which indicate that a small percentage of patients account for a very high percentage of total medical care expenditures, and these high-use patients tend to practice unhealthy life styles. Among the articles that they mention are Zook et al. [36] and Schroeder et al. [31]. The authors of the first article sampled six hospitals and discovered that a high percentage of patients were abusers of alcohol, tobacco, drugs, tended to be obese and did not follow the treatment directions of their physicians. In the latter study, the authors found that 12 percent of hospital patients used over 50 percent of the medical care of the total sample, and these patients tended to be repeaters. Therefore, a small drop in the use of care by high risks could lead to dramatic decreases in total medical expenditures. Pupp [28] found that smokers and people with high blood pressure used more inpatient and outpatient care than their counterparts. Fuchs [17] pointed out that the mortality rate in Utah is much lower than in Nevada, a fact which is almost certainly due to the healthier life styles of the Mormons in Utah. Auster et al. [3] discovered that environmental variables (including per capita cigarette consumption by state) are more important in determining mortality rates than medical care. On balance, we suggest that the use of CR, which helps to insulate people from the economic consequences of their unhealthy life styles, provides undesirable incentives. It should be noted that those who suffer from serious and expensive illness could be aided by a catastrophic stop-loss, possibly patterned after Feldstein [12] which involves a far milder adverse incentive effect.

Enthoven's final reason for supporting CR is his contention that it will control free riders. To Enthoven, free riders are people who buy little or no insurance until they become ill, then saddle the carrier with huge bills and drop out again when well. (Free riders are not charity cases, rather they are customers who only purchase insurance when illness is apparent.) Enthoven believes that free riders can abuse the system because the need for care, although involuntary, is predictable [5, 8; 6, 473]. He ignores the fact that the *raison d'etre* of insurance is to protect against events that may occur, but with a probability less than one. If illness were perfectly predictable, there would

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be no insurance markets. Rational people will be most likely to insure if the premium is actuarially fair; if it is actuarially unfair (as it is to low risks under CR), many will decide to self-insure unless and until illness strikes [16]. So we maintain that the free rider problem is not solved by CR, but rather is exacerbated by it. If free riders are a problem, they should not be handled by CR, but by insurance clauses which preclude pre-existing conditions, or employ other exclusionary provisions.

Enthoven further speculates that if CR is not required, fee-for-service QHP's may attract low risk individuals by offering a basic plan contianing high copayments and a very low premium. This saddles existing HMO QHP's with a greater ratio of higher risk and higher medical outlays, which might bankrupt them. To avoid bankruptcy, the HMO's will offer the same coverage with high copayments and essentially become fee-for-service QHP's. In Enthoven's opinion, this would be unfortunate, since he sees HMO's as being more efficient than fee-for-service outlets.

This scenario begs a number of questions. First, are HMO's more efficient than fee-for-service practitioners? Luft [21] indicates that this is unclear. Second, Enthoven argues that demand creation by fee-for-service physicians is a more serious problem than overutilization by consumers because of the lack of cost sharing. Indeed, demand creation is a problem; both Monsma [26] and Fuchs [18] have empirically demonstrated demand creation by fee-for-service physicians. On the other hand, the lack of cost sharing (in either HMO's or fee-for-service) can lead to overutilization. (The relative influence of each of these factors is more fully discussed in Reinhardt [30]). This problem, though, will not disappear with CR; rather it will be necessary to institute both patient and provider incentives to encourage cost consciousness.

Another unfortunate side effect of CR is that it lowers the incentive for individuals to develop and maintain good health habits. Zeckhauser et al. [35] have shown that employer programs such as anti-smoking courses have considerable promise in reducing medical costs. However with state-wide CR, as proposed by Enthoven, the QHP cannot reward those who develop more healthy life styles with lower rates, and this blunts the appeal of programs encouraging weight loss, non-smoking, etc., and thus also reduces the desire of employers and

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QHP's to offer such programs. Clearly the requirement for CR is the weak link in Enthoven's Consumer Choice Health Plan.

Summary and Recommendations

CCHP is Alain Enthoven's proposal to alleviate some of the inefficiencies which plague the health care financing system in America. The plan has three parts: 1) The subsidization of health insurance costs by tax credits to individuals and families, rather than by employer tax deductions, 2) a stipulation that tax credits will be extended only if coverage is purchased from a QHP, and 3) a requirement that all QHP's practice CR and annual open enrollment.

The first two components of Enthoven's plan have merit. Shifting from employer deductions to tax credits would improve coverage for non-workers. For most individuals, the maximum credit would be set at 60 percent of the cost of a basic QHP, and consumers would bear the full cost of more extensive coverage. Enthoven thus achieves the objective of providing basic coverage to virtually everyone, while still encouraging consumer cost consciousness. By contrast, the current system, with unlimited employer deductions, has helped to propel health costs upward at a rate much greater than that of general prices, while still denying health coverage to some people.

CR, the last part of the CCHP proposal, is basically anti-competitive and, like other mandated price controls, engenders perverse incentives. It would subsidize the minority of individuals who, due to their unhealthy life styles, consume a disproportionate share of all medical care. The fact that these people would not have any economic incentive to reduce their intake of alcohol, tobacco or drugs, to lose weight, or to take steps to lower their blood pressure is extremely unfortunate, because a small decrease in expenditure for high risks could dramatically reduce total medical outlays.

In addition, CCHP would require a new layer of bureaucracy to monitor the certification of QHP's, CR, and annual open enrollment. This cost too must be set against the main benefit of CCHP, which is the promotion of more consciousness among consumers. On balance, we believe the costs of CCHP outweigh its benefits.

We do not want to leave the impression that CCHP without

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CR and the added regulations would be a panacea; the modified plan deserves support, but it would only have a moderate impact on medical care expenditures and costs. More extensive changes that could be made include eliminating discriminatory tax advantages for non-profit insurers [14], anti-trust enforcement to remove barriers which inhibit HMO's and profit-making firms from providing alternative forms of coverage [19], and relaxing regulations to permit more substitution among health professions]15]. While not advocating complete deregulation of the medical care industry, we do urge a greater reliance on market forces to improve quality and restrain the rapid increase in medical expenditures. Enthoven's plan, once shorn of its requirement for community rating, is at least a step in the right direction.

FOOTNOTES

(1) If a taxpayer does not get insurance through the workplace, but buys it individually, up to $150 of the premium may be deducted. Premiums in excess of $150 and other medical expenses above 3 percent of adjusted gross income (AGI) may be deducted on itemized tax returns. (U.S. Tax Code 213). However, the tax expenditure on this deduction is not nearly as large as that on health insurance purchased in the workplace [10; 34]. Beginning in 1983, the deduction of up to $150 is repealed. Also, only medical expenses above 5 percent of AGI will be deductible. After 1984, deduction for drug expenditures above 1 percent of AGI will not be allowed, and only prescription drugs and insulin will be deductible expenses.

(2) It is generally held that the employer shifts the cost of fringes, such as insurance payments, to the employee in the form of lower wages [24, 501].

(3) Coinsurance and deductibles will be referred to as copayments in this paper unless otherwise specifically stated.

(4) Lynk [22] analyzes the labor and insurance market effects of the requirement that employers must allow their workers to choose among the policies of at least three different insurance companies in order to maintain the tax deductable status of the employer contributions.

(5) In insurance literature, an experience rate is also called a fair premium. That is, it is actuarially fair.

(6) It is not clear in the tax code whether employer contributions for non-group plans are excludable. We contacted the IRS for an interpretation, and were told that they are currently grappling with the issue. We were unofficially told that any plan which discriminates between employees in terms of coverage or premiums will probably not be allowed. This unofficial opinion is based on section h of U.S. Tax Code 162 which does not allow any differentiation of coverage between end stage renal disease and other employees.

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BOOK REVIEW

THE KREMLIN'S VIEW OF DETENTE: A REVIEW OF GELMAN'S *THE BREZHNEV POLITBURO AND THE DECLINE OF DETENTE*

By Richard Brown

A decade has now passed since the era of detente; an era in which East-West relations appeared to have overcome the "psychological barriers" that were deemed to have mired the two opposing camps in a cold war for over a quarter of a century. In the West, detente was perceived foremost as diminishing the haunting specter of nuclear war. For Europeans, in particular, detente was also perceived as diminishing the threat of another conventional war on the continent. For Americans, detente was a ray of light piercing the overcast of Vietnam. Beyond these psychological effects, detente yielded certain tangible economic and cultural benefits which brought the business, labor, and intellectual communities of the West to its defense. The era of detente was a truly heady period in East-West relations, and as with all such times, a period when critical voices were readily dismissed.

Detente faded in the latter 1970s due largely to Western disillusionment over the Soviet Union's expansionist policies during that time. Today, however, as the events associated with those policies begin to recede from our collective conscience, one senses a longing in the West for a return to the halcyon days of trade, summit meetings, cultural exchanges, bilateral treaties, and scientific cooperation. In Western Europe, especially, interest in improving relations between the superpowers is being reinvigorated. Even the smallest sign of a thaw in relations, such as Gorbachev's visit to Great Britain last December or the Schultz-Gromyko meeting in Geneva a month later, commands enormous media attention in the West. "Improved Relations" between East and West is today a political end in itself, not a means.

The current groundswell of opinion favoring improved East-West relations makes Harry Gelman's *The Brezhnev Politburo and the Decline of Detente* a timely publication. Gelman's book is a study of the rise and fall of detente from a Soviet

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perspective. Other scholars, most notably Richard Pipes, have also analyzed detente from a Soviet perspective but have concentrated primarily on its geopolitical and ideological dimensions. Gelman, who is a Senior Staff Member at the Rand Corporation, also includes chapters on these topics, but his study of detente is distinguished by its revealing look into the Byzantine world of Soviet politics. Gelman discusses the major power trends inside the Brezhnev Politburo and how they influenced Soviet attitudes towards detente. He also discusses Brzhnev's adroitness in exploiting these trends for personal gain. Though no study of internal Soviet politics can be definitive, Gelman's book is less speculative than most. In this way the author achieves his goal of contributing to Kremlinology in the tradition of Michael Tatu and Robert Conquest.

Gelman's main thesis is that detente had an entirely different set of assumptions in the Soviet Union than it did in the West. Moscow's objectives in pursuing detente had little in common with the West's desire for reducing global conflict. On the contrary, Moscow's decision to pursue detente was made in the context of a major military buildup and a growing influence of the military establishment in Soviet decision making – both of which fueled a pre-existing impulse to expand.

As evidence, Gelman describes the political factors behind Brezhnev's consolidation of power after the displacement of Khrushchev. In brief, Brezhnev was able to forge an alliance with the leaders of the military, the security forces and the ideologues in the party Secretariet by supporting a reversal of Khrushchev's priorities in these areas (Khrushchev had favored the consumer and agricultural sectors of the economy over the military and capital goods sectors, and a limited political liberalization). His hard-line stance enabled Brezhnev to eclipse the rival faction in the Politiburo, led by Nikolai Podgorny, who believed that Nikita Sergeyevich had the right ideas and was only misguided in his methods. Gelman describes several subsequent political maneuvers by Brezhnev which had the common thread of enhancing the Politburo's pro-military faction. In 1973, for example, Brezhnev brought the heads of the three "national security" bureaucracies (the foreign ministry, the KGB, and the defense ministry) into the Politburo. He also strengthened the influence of the Defense Council, a body responsible for defense matters, in the Politburo's decision

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making.

In achieving the reversal in priorities, Brezhnev established the groundwork for his opening to the West. According to Gelman, his objectives were to seek technology and consumer goods from the West to help compensate for the reduction in investment in these sectors. Arms contol, Brezhnev's carrot to the West, was not to include anything that the military had already planned for.

The picture that emerges from Gelman's analysis of the rise of detente is that of a powerful pro-military influence in the Brezhnev Politiburo's decision making process. Domestic development and detente were subordinate to military and military-related prerogatives. In this regard, Gelman analogizes detente to an island in a stream of continuous Soviet efforts from the 1960s to the 1980s to displace the U.S. in the world. "Like an island, detente neither halted nor changed the surrounding process." Kissinger's supposed strategy of entangling the Soviets in a web of interrelationships that would temper their aggressive impulses, overestimated Moscow's pliability.

In his discussion of the decline of detente, Gelman again points to the militarist and ideological forces operating inside the Politburo. By 1975, the Soviet Union's growing "predisposition to act" combined with American impotence and several fortuitous international conflicts to produce a marked increase in Soviet adventurism. Only then did it become evident to the main body of Western opinion that the spirit of detente had a different face in Moscow than in the West.

As for the Soviets, Gelman's description of their attitude toward the decline of detente provides an instructive insight into their thinking. The Soviets, Gelman states, interpreted their expansionist behavior not as a betrayal of detente, but as an entirely appropriate response consistent with the changing global correllation of forces. The Soviets believed further that it was the American public reaction to their behavior that was inappropriate; "a reflection of the unfortunate influence of misguided or intransigent forces in the American elite who were unable to accept with grace the historic inevitability of either the U.S. defeats of the 1970s or the Soviet advances." When combined with a militarist/expansionist disposition, such moral relativism creates an ominous presence; one that many in the West seem prepared to again disregard in the pursuit of "im-

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proved relations."

Gelman states that by the early 1980s Brezhnev was on the political defensive because attention to defense matters began to "level-off". Gelman offers no explanation here, but one can speculate that this may have been a manifestation of the general sloth that characterized Soviet bureaucracy in Brezhnev's later years. Whatever the cause, the Politburo's pro-military faction sought to exert its influence in the succession struggle following Brezhnev's death. They were apparently successful, according to Gelman, as Brezhnev's chosen successor, Konstantin Chernenko, was bypassed in favor Yuri Andropov, who enjoyed the support of then Defense Minister Ustinov. Andropov, like Brezhnev before him, rode the crest of the prevailing political trend in the Politburo to the apex of Soviet power. Though Gelman's book ends with the advent of Andropov, his research leads one to conclude that Chernenko subsequently relieved the pro-military faction of its earlier doubts about him.

Insights such as these, although oblique by comparison to more open societies, make *The Brezhnev Poltiburo and the Decline of Detente* an important contribution to our understanding of Soviet thinking and behavior in the present period of renewed pressure for accommodating with the Soviet Union. Gelman's book underscores the point that sober appraisals of what is relistically achievable with the current generation of Soviet leaders are needed if the opinion favoring "improved relations" with the Soviet Union is to be put in its proper perspective. For though Brezhnev, Suslov, Andropov, and Ustinov have passed on, the pattern of militarism and ideological discipline in the Soviet Union endures. It is therefore unreasonable to expect that the basic foreign policy corrollaries of this pattern will change, even under the leadership of a new generation represented by Gorbachev. On the contrary, as Gelman argues, "it is plausible to suppose that the leadership now hopes, through a slow return of the pendulum of American opinion, eventually to obtain a bilateral improvement without any modification in behavior in the world at large."

Gelman does not offer any hope for a way out of this plight. Some reassuring note in this regard would have been welcomed, even if only the obvious changeover in generations of Soviet leadership. But this is an aesthetic point that does not detract from the book's effectiveness. Overall, the book is rich in detail

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and its points are well argued. The book is written in a very readable style and has a very humane length. Its appeal lies in its presenting a realist's view of the Soviet Union without the emotional anti-communist clarion call to arms which, however justifiable, is unattractive to many readers.

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THE LONG JOURNEY: VIETNAMESE MIGRATION AND SETTLEMENT IN AUSTRALIA

Nancy Viviani
Melbourne University Press, Carlton, Victoria

Cut off from Europe by the billions of Asia, Australia has for generations favored a 'White Australia' immigration policy – bostered by the belief, the conviction, that without such a policy the pressures of Asian immigrants could result in a demographic invasion which would convert Austria into just one more Asian country.

This policy remained intact until after World War II, when changes in the composition of the Australian elite – industrial and commercial, educational and political – led to the rise of an internal lobby favoring the 'emancipation' of the Australian aboriginals – now largely of mixed blood – and the lowering of barriers against colored immigration. Despite the title of her book, author Nancy Viviani has directed her research not to the "long journey" from Vietnam to Australia, but to the political and social struggle which resulted from the Australian government decision to admit the Indochinese "boat people" to Australia in the face of opposition from over two-thirds of the Australian electorate.

The latter goal became a political possibility when humane sentiments were aroused by the plight of the Vietnamese boat-people. Pemitted – possibly even encouraged – to emigrate from Vietnam by the new Communist regime, in the wake of the withdrawal of American support for non-Communist South Vietnam, large numbers of Vietnamese immigrants attempted to obtain admission to neighboring Asian countries, but were increasingly refused entry on the principle that immigration is equivalent to conquest. Thus author Viviani comments:

"Finally, in June 1979 the Malaysian Prime Minister Datuk Hussein Onn announced that no more refugee boats would be allowed to land. The Malaysians in fact had been pushing some boats off since 1975, but now all boats were to be resupplied and sent on. As Singapore had refused since 1975 to allow boats

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to land without guarantees of resettlement from third countries, the effect of the Malaysian decision was to transfer landfall to Indonesia . . . A little later, the Philippines also closed its doors to refugees."

Seeing an opportunity in these circumstances to break down Australian traditions of racial exclusiveness, the Australian government authorized the acceptance of Vietnamese immigrants into Australia on grounds of humanity. This move did not pass unopposed, even though it was supported by a well-orchestrated media campaign:

"The Queensland RSL State Congress had several motions before it condemning Australia's acceptance of 'supposed refugees', and in mid-June, a nationwide poll confirmed that Australians were clearly divided on the question of refugee entry. In the poll, 30 percent of respondents believed Australia should accept about the same numbers of refugees or more. This was the bedrock of support for the government's policies. Another 30 percent wanted fewer to enter, while 37 percent wanted no more accepted. Thus more than two-thirds of those polled wanted fewer Indochinese to enter Australia."

Meanwhile the USA exerted pressure on Australia and neighboring countries to aid the outflow from Vietnam, with only limited success:

"The United States also placed Japan under pressure to make a substantial response. The Japanese, however, refused an American request to take 10,000 refugees, though later agreeing to take 200 Vietnamese from Malaysia and to pledge more money for UNHCR support."

"France, which had earlier cut its intake of refugees, agreed to take 5,000 more. At the end of June, after a summit meeting of the 'Big Seven' in Tokyo, the United States, as an exemplar, had doubled its refugee entry quota to 14,000 a month."

"The rapidity with which these international events took place, and the inundation of the Australian media with human-interest stories and interpretive reporting on the crisis (particularly by Michael Richardson) raised the temperature of the debate on entry of Vietnamese to Australia considerably during June and July of 1979. There was a crisis, and this was fully reflected in the emotional treatment of the issue in the Australian media. Most newspaper editorials were firmly in favor of increasing the numbers of refugees Australia should take."

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Despite the traditional White Australia policy, the author argues that Australians were not traditionally ideological racialists. However, the appearance of increasing numbers of Asians in their midst – a people who customarily produced families much larger than those of White Australians – provoked public resentment. This was largely spontaneous, however, and was no match for the determined and sustained pro-immigration policy of the government and the media.

"Peter Hastings quickly to point out in the *Sydney Morning Herald* that despite the growth of racism in Australia, we would need to take more refugees so as to avoid the political folly of offending our ASEAN neighbors who carried the largest load. Newspapers gave good coverage to the arguments of the 'refugee lobby'; the ICRAs, the Vietnamese Associations, the Catholic Commission for Justice and Peace and the Anglican Synod all called for the government to admit more refugees. The Rev. Ted Noffs of the Wayside Chapel argued flamboyantly that we should take the lot."

"It was clear, though there were few to acknowledge it publicly, that a majority of Australians were against even maintaining the current intake of refugees, and that this was acting as *the* major constraint in preventing the government from increasing the refugee target."

"Finally, the government appointed a Refugee Advisory Council to advise it on reception and resettlement of refugees and on action 'to produce a more understanding and tolerant community attitude towards refugees'."

Today, for the first time in its history, Australia has an internal race problem (other than that of its aboriginees), and this is a problem which is becoming linked in the Austrian mind to the problem of the aboriginees. While White New Zealand had largely come to accept the Maori population as autochthonous and legitimate, any possibility that the White Australians will now accept their aboriginals in the same way seems to have become irreversibly linked to the question of the status of the new 'Vietnamese Australians'. The Asian immigrants do not seem anxious to assimilate, and the White Australians have acquired a new race consciousness, and a certain bewilderment at the rapidity with which the old Australia they knew has been converted so quickly into a multi-racial Australia. As the author concludes:

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"One of the effects of Vietnamese migration to this country has been to sharpen the question of what it is to be an Australian. Before the war Australians were quite clear on this. They were a mixed Anglo-Saxon and Celtic people in race and culture, and if prompted, they would also remember black Australians. After the war the effects of immigration led to major and partly successful attempts to change this self-perception. The official adoption of the ideology of a multicultural society has meant that we have less of a sense of what it is to be an Australian, despite substantial efforts to persuade us that to be an 'ethnic' Australian is desirable."

THE POLITICAL ECONOMY OF DEVELOPMENT IN INDIA

Pranab Bardhan
Basil Blackwell, Oxford and New York

India, the second largest country in the world in terms of population, is also one of the poorest. Yet her enormous resources, her elaborate administrative and legal systems, bequeathed largely by the English, her large internal market and high savings rate give her the potential to become an economic giant. Why, then, has per capita income been growing at the rate of the only 1½ percent per year over the last thirty years, leaving nearly half the population in abject poverty?

In this wide-ranging and readily accessible book a well-known economist examines the political and economic constraints on Indian development. He demonstrates the central role of public investment in agricultural and industrial infrastructure and public management of capital in economic growth. He explores the nature of the relationship between government and society in India and reveals the retarding influences of corruption, nepotism and patronage. He then traces the impact of these factors on the functioning both of the economy, in particular its growth process, and of the polity, in particular its democratic process.

While it is customary to laud India as the world's largest democracy, the author's portrayal of the reality is hardly complimentary to the image of democracy. Thus, he writes:

"The Indian style of politics is deceptively consensual, but

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over the years the process of intense bargaining and hard-fought apportionment of benefits among the different partners of the dominant coalition have come out more into the open, and politics has acquired a more unseemly image in the public mind. And, as in all large complicated bargaining counters, there has emerged a group specializing as brokers, who act as agents for different bargaining interest groups, and, of course, take a cut for themselves for services rendered. These are gangs led by a large number of MLAs and MPs, political middlemen who over the years have specialized in the profession of brokerage services. The fees they charge and part of the favors they engineer for their clients in exchange are usually unaccounted in the official statistical book-keeping, contributing to the thriving underworld of what is called 'black money'. As elections have become more expensive and as their professional expertise in brokerage has increased, these fees skimmed off the surplus of the economy have multiplied over the years."

While large spoils go to the the politicians and the leaders of almost every pressure group, the rapidly expanding population remains impoverished, and this situation leads to frequent social disruptions. These further exacerbate the evils arising from corruption and place a heavy burden upon the economy. Today, India strains under these costly restraints:

"While from time to time a significant number of crumbs have to be thrown at these clamoring groups banging at the gates just outside the periphery of the dominant coalition, equally expensive is the process of manning and securing those gates, and of controlling the crowds if they every look threatening: the cost of the expanding police and paramilitary forces has risen enormously."

If the economy had been expanding proportionately to the level of investment, foreign aid, and the introduction of Western technology in the form of fertilizers and machinery, all the above might have been supported. But this has not been the case. The government and bureacracy participate in all planning, regulating new projects and as a result:

"Expensive projects are hastily initiated on grounds of political expediency or regional favoritism, without proper design and preliminary spade-work, resulting in long delays and cost escalations. The deliberate promotion of trade unions affiliated to the ruling political party often leads to damaging

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union rivalries and irresponsible 'economism'. Overstaffing, 'featherbedding', fake payrolls, absenteeism in regular hours and working only for 'overtime' payments, and other irregularities are condoned, if not actively encouraged, by trade unions and their political bosses by citing flagrant cases of corruption, political patronage and cronyism at the top in many public enterprises. Irresponsibilities at the managerial, technical and worker levels thus feed on each other, creating a general atmosphere of demoralization and parasitism on the state. Plundering of public-sector-produced goods by agents of influential politicians in collaboration with public enterprise staff, private contractors and the criminal underworld is far too common. For instance, just between April 1981 and January 1982, 2 million tonnes of coal valued at Rs 300 million were looted from the Asansol-Ranigunj coal-belt alone."

Author Pranab Bardhan has been brutally honest about the true state of affairs in the world's "largest democracy", the supposed showcase of parliamentary democracy amongst the nations of the Third World. He reveals a world in which government regulations are imposed to increase the opportunities for extortion and corruption, rather than for the good of the economy or of the population at large. Little can be achieved without bribery or nepotism, and economic activity and investment is customarily diverted, as a consequence of these conditions, into areas other than those which would be economically most effective.

This is a case study which has value not only in helping us to understand the plight of India, but in revealing principles and forces to be found in so many of the less advanced, hopefully "developing" countries of the world. It is the kind of realistic study which is necessary if anything is to be achieved in face of the problems now crowding in rapidly upon this ever-shrinking, increasingly over-populated world.

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